(4)

No. 93-404

In The

Supreme Court of the United States

October Term, 1993

ARTHUR L. GUSTAFSON, DANIEL R. McLEAN AND FRANCIS I. BUTLER,

Petitioners,

v.

ALLOYD CO., INC. AND WIND POINT PARTNERS, II, L.P.,

Respondents.

On Writ Of Certiorari To The United States Court Of Appeals For The Seventh Circuit

JOINT APPENDIX

DONALD W. JENKINS*
THOMAS P. DESMOND
JENNIFER R. EVANS

VEDDER, PRICE, KAUFMAN & KAMMHOLZ
222 North LaSalle Street
Chicago, IL 60601
(312) 609-7500

Counsel for Petitioner Arthur L. Gustafson

* Counsel of Record

HAROLD C. WHEELER*
PETER C. WOODFORD
DEBRA A. WINIARSKI

SEYFARTH, SHAW, FAIRWEATHER & GERALDSON
55 East Monroe Street
Chicago, IL 60603
(312) 346-8000

Counsel for Petitioners Daniel R. McLean and Francis I. Butler

* Counsel of Record

ROBERT J. KOPECKY*
BRIAN D. SIEVE
CAROLE A. CHENEY

KIRKLAND & ELLIS
200 East Randolph Drive
Chicago, IL 60601
(312) 861-2000

Counsel for Respondents

* Counsel of Record

Petition For Certiorari Filed September 9, 1993
Certiorari Granted March 7, 1994

COCKLE LAW BRIEF PRINTING CO., (800) 225-6964
OR CALL COLLECT (402) 342-2831

TABLE OF CONTENTS

RELEVANT DOCKET ENTRIES

U.S. District Court
Northern District of Illinois (Chicago)

Proceedings include all events.
Alloyd Co Inc, et al v. Gustafson, et al

2/11/91	1	COMPLAINT
3/20/91	19	AMENDED COMPLAINT [1-1] by plaintiff; jury demand
3/22/91	8	ANSWER TO FIRST AMENDED COMPLAINT by defendant Arthur L Gustafson
3/26/91	14	ANSWER to first amended complaint by defendant Daniel R McLean, defendant Francis I Butler; jury demand
10/22/91	51	Document Sealed (pursuant to Court Order) Motion by defendants for summary judgment and rule 12(m) statement of undisputed facts (cmf)
10/31/91	58	Document Sealed (pursuant to Court Order of 07/09/91). Memorandum by defendants in support of motion for summary judgment.
11/12/91	60	RESPONSE by plaintiffs to defendants' motion for summary judgment.
11/12/91	62	RULE 12 (N) Statement in response to defendants' Rule 12 (M) Statement by plaintiffs
11/27/91	69	REPLY by defendants in support of defendants' motion for summary judgment.

5/29/92	74	MINUTE ORDER of 5/29/92 by Hon. Ann C. Williams : Pursuant to memorandum opinion and order, the court grants defendants motion for summary judgment and denies plaintiffs' motion for summary judgment as moot. Memorandum opinion and order entered under seal.
6/25/92	76	NOTICE OF APPEAL by plaintiff Alloyd Company Inc and plaintiff Wind Point Partners II, L.P. from motion minute order
6/25/92	77	JURISDICTIONAL STATEMENT by plaintiff Alloyd Company Inc, and plaintiff Wind Point Partners II, L.P. regarding appeal
3/24/94		REPORT AND RECOMMENDATION of Hon. Joan H. Lefkow: Both plaintiffs' and defendants' motion for summary judgment be denied.

U.S. COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

6/29/92	Private civil case docketed. [92-2514]
6/29/92	Filed Appellant Alloyd Company, Appellant Wind Point jurisdictional statement.
7/7/92	Added attorney Michelle H. Browdy per appearance form for Appellant Alloyd Company, Appellant Wind Point.
7/7/92	Appearance form filed for Appellant Alloyd Company, Appellant Wind Point by attorneys Michelle H. Browdy, Robert J. Kopecky and Brian D. Sieve.
7/7/92	Filed "MOTION TO HOLD BRIEFING IN ABEYANCE PENDING THIS COURT'S DECISION IN ANOTHER PENDING CASE" by Appellant Alloyd Company, Appellant Wind Point.
7/8/92	ORDER: Filed clerk's notice to Arthur L. Gustafson, Daniel R. McLean and Francis I. Butler to file 0&3 copies of response to MOTION TO HOLD BRIEFING IN ABEYANCE PENDING THIS COURT'S DECISION IN ANOTHER PENDING CASE.
7/9/92	Orig. record on appeal filed. Contents of record: 1 vol. pleadings; 1 vol. transcripts; 3 envelopes filed IN CAMERA.
7/9/92	Appearance form filed for Appellee Daniel R. McLean and Francis I. Butler by attorney Debra A. Winiarski, Peter C. Woodford, Harold C. Wheeler.
7/9/92	Added attorney Michael L. Kayman per appearance form for Appellee Arthur L. Gustafson.

7/9/92	Appearance form filed for Appellee Arthur L. Gustafson by attorney Michael K Kayman, Sheryl A. Kuzma, Donald W. Jenkins.
7/14/92	Filed Appellee Arthur L. Gustafson, Appellee Daniel R. McLean, Appellee Francis I. Butler response to Appellant Alloyd Company, Appellant Wind Point motion to hold the briefing schedule IN ABEYANCE.
7/16/92	Supp. record on appeal filed.
7/16/92	ORDER issued GRANTING motion to abate case and this appeal is HELD IN ABEYANCE pending the court's decision in Pacific Dunlop Holdings, Inc. v. Allen & Company, Inc. and Daniel Heffernan, No. 91-2346, set for oral argument on 9/11/92. Counsel shall file a status report within 10 days of the court's decision in Pacific Dunlop or on 11/16/92, whichever date earlier occurs.
7/28/92	Filed "AGREED MOTION TO UNSEAL DOCUMENTS" by Appellee Francis I. Butler, Appellee Daniel R. McLean, Appellee Arthur L. Gustafson, Appellant Wind Point, Appellant Alloyd Company.
7/30/92	ORDER issued GRANTING "AGREED MOTION TO UNSEAL DOCUMENTS".
8/12/92	Filed Seventh Circuit Transcript Information Sheet by Brian D. Sieve for Appellant Alloyd Company, Appellant Wind Point.
11/16/92	Filed status report by Appellant Wind Point, Appellant Alloyd Company.

11/17/92	ORDER re: Status report of 11/16/92. Counsel for Appellant Wind Point, Appellant Alloyd Company are ordered to file a further status report.
1/4/93	Filed status report by Appellee Francis I. Butler, Appellee Daniel R. McLean, Appellee Arthur L. Gustafson, Appellant Wind Point, Appellant Alloyd Company.
4/30/93	ORDER re: Status report of 1/4/93. Counsel for Appellee Francis I. Butler, Appellee Daniel R. McLean, Appellee Arthur L. Gustafson, Appellant Wind Point, Appellant Alloyd Company are ordered to file a further status report.
5/19/93	Filed motion by Appellant Wind Point, Appellant Alloyd Company to remand case [493637-1] and, to vacate the district court's judgment.
5/20/93	ORDER: Filed clerk's notice to Francis I. Butler, Daniel R. McLean, Arthur L. Gustafson to file 0&3 copies of response to "MOTION TO VACATE JUDGMENT AND REMAND TO THE DISTRICT COURT" filed herein on 5/19/93, by counsel for the appellants.
5/28/93	Filed Appellee Francis I. Butler, Appellee Daniel R. McLean, Appellee Arthur L. Gustafson response to Appellant Wind Point, Appellant Alloyd Company motion to vacate judgment and to remand case to district court.
6/2/93	Filed motion by Appellant Wind Point, Appellant Alloyd Company to file reply in support of their motion to vacate and remand.

6/3/93	Filed status report by Appellee Francis I. Butler, Appellee Daniel R. McLean, Appellee Arthur L. Gustafson, Appellant Wind Point, Appellant Alloyd Company.
6/11/93	ORDER issued DENYING plaintiff-appellants' Motion to File Reply in Support of their Motion to Vacate and Remand as unnecessary. The judgment of the lower court is vacated and the case is REMANDED to the district court for further proceedings in light of this court's opinion in Dunlap Holdings, Inc. v. Allen & Co., No. 91-2346 (7th Cir. May 7, 1993).
6/30/93	MANDATE ISSUED AND ENTIRE RECORD RETURNED.
7/1/93	Filed motion by Appellee Francis I. Butler, Appellee Daniel R. McLean, Appellee Arthur L. Gustafson to recall and stay the mandate.
7/7/93	Filed Appellant Wind Point, Appellant Alloyd Company opposition to Appellee Francis I. Butler, Appellee Daniel R. McLean, Appellee Arthur L. Gustafson motion for recall and stay of mandate.
7/8/93	ORDER issued DENYING motion to recall and stay of mandate.
7/9/93	ORDER re: Opposition to Motion for Recall and Stay of Mandate filed 7/7/93 by counsel for the appellants. On 7/8/93, this court denied appellee's motion to recall and stay the mandate. Accordingly, IT IS ORDERED that the Opposition to Motion for Recall and Stay of Mandate will be filed without further court action.

9/20/93	Filed notice from the United States Supreme Court of the filing of a Petition for Writ of Certiorari.
3/14/94	Filed order from the United States Supreme Court GRANTING Petition for Writ of Certiorari.

UNITED STATES COURT OF APPEALS

For the Seventh Circuit
Chicago, Illinois 60604

June 11, 1993

Before
Hon. WILLIAM J. BAUER, Chief Judge
Hon. FRANK H. EASTERBROOK, Circuit Judge
Hon. MICHAEL S. KANNE, Circuit Judge

ALLOYD COMPANY, INCORPORATED, formerly known as ALLOYD HOLDINGS, INCORPORATED, a Delaware Corporation and WIND POINT PARTNERS II, L.P., a Delaware Limited Partnership, Plaintiffs-Appellants,	]	Appeal from the United States District Court for the Northern District of Illinois, Eastern Division.
No. 92-2514 v. ARTHUR L. GUSTAFSON, DANIEL R. MCLEAN and FRANCIS I. BUTLER, Defendants-Appellees.	]	No. 91 C 889 Ann Claire Williams, Judge.

This matter comes before the court for its consideration of the following documents:

1. **MOTION TO VACATE JUDGMENT AND REMAND TO DISTRICT COURT** filed herein on 5/19/93, by counsel for the appellants.

2. **DEFENDANTS-APPELLEES' RESPONSE TO PLAINTIFFS-APPELLANTS' MOTION TO VACATE JUDGMENT AND REMAND TO DISTRICT COURT** filed herein on 5/28/93, by counsel.

3. **PLAINTIFFS-APPELLANTS' MOTION TO FILE REPLY IN SUPPORT OF THEIR MOTION TO VACATE AND REMAND** filed herein on 6/2/93, by counsel.

On consideration thereof,

IT IS ORDERED that the Plaintiffs-Appellants' Motion to File Reply in Support of their Motion to Vacate and Remand is **DENIED** as unnecessary. The judgment of the lower court is **VACATED** and this case is **REMANDED** to the district court for further proceedings in light of this court's opinion in *Pacific Dunlop Holdings, Inc. v. Allen & Co., Inc.*, No. 91-2346 (7th Cir. May 7, 1993).

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

ALLOYD CO., INC., et al.,	)	
Plaintiffs,	)	
	)	Case No.
v.	)	91 C 889
ARTHUR L. GUSTAFSON, et al.,	)	
	)	
Defendants.	)	

MEMORANDUM OPINION AND ORDER

Plaintiffs Alloyd Co., Inc., formerly known as Alloyd Holdings, Inc. ("Holdings") and Wind Point Partners II ("Wind Point") brought this suit against defendants Arthur Gustafson ("Gustafson"), Daniel McLean ("McLean"), and Francis Butler ("Butler"). The plaintiffs claim that the defendants made material misrepresentations when selling all their stock in Alloyd, Inc. ("Alloyd") to them in violation of Section 12(2) of the Securities Exchange Act of 1933 ("Section 12(2)") and in breach of the pertinent stock purchase agreement (the "Agreement"). The parties subsequently brought cross-motions for summary judgment. For the reasons stated below, the court grants defendants' motion for summary judgment and denies plaintiffs' motion as moot.

Background

In 1989, Gustafson, McLean and Butler were the sole shareholders of Alloyd, a manufacturer of clear plastic blister packaging and automatic heat seal packaging equipment. After deciding to sell the company, Alloyd

engaged KPMG Peat Marwick ("KPMG") to find a buyer. In the course of soliciting purchasers, KPMG prepared a "profile" describing the company to distribute to parties expressing serious interest in purchasing Alloyd. A copy of this profile was sent to Wind Point.

On August 11, 1989, Wind Point submitted a letter summarizing its interest in Alloyd. Wind Point representatives were then invited to visit Alloyd's physical plant. By October 17, 1989, Alloyd agreed to sell substantially all of its issued and outstanding stock to Holdings, a new corporation to be formed by Wind Point to effectuate the sale of Alloyd. Holdings was subsequently incorporated on November 17, 1989 with McLean and Butler serving as its officers and directors, and Wind Point, McLean, Butler, Carl Lutz, William Lord, and Henry Young as its shareholders.

While negotiating the terms of the Agreement, Wind Point conducted extensive due diligence regarding Alloyd. KPMG also conducted a formal business review of Alloyd and performed other procedures relating to Alloyd's financial statements. KPMG was to report on Alloyd's inventory as well as other aspects of the company's financial performance. Of particular interest to this case, KPMG provided inventory information based upon estimates of the costs of goods sold and gross profits. KPMG could only provide estimates because Alloyd only took inventory at the end of each year. Although the appropriateness of taking a physical inventory was discussed, no physical audit was taken prior to closing on the sale.

At the closing on December 20, 1989, Holdings acquired Alloyd's stock for $18,709,000 plus $2,122,219 to reflect the estimated adjustment amount of Alloyd's earnings. The Agreement signed by Alloyd and Holdings set forth detailed procedures to be followed after the year-end audit was conducted to remit the appropriate amount should the audit disclose a variance between Alloyd's estimated and actual earnings for that year.

By February 8, 1990, McLean determined that Alloyd's actual 1989 earnings and year-end net book value were significantly less than the estimates relied upon to determine Holding's payment of the estimated adjustment amount. This variance was attributed to the fact that Alloyd's year-end inventory was significantly lower than estimated. After confirming the discrepancy, McLean met with Richard Kracum, a general partner of Wind Point and a director of Holdings, and other Wind Point employees to inform them of the shortfall in Alloyd's inventory. On February 11, 1991, the plaintiffs instituted the instant law suit. Pursuant to the adjustment provision in the Agreement, on March 11, 1991, the defendants repaid $815,000 plus interest to Holdings to cover the difference between the estimated adjustment amount paid by Holdings at the closing and the actual adjustment amount due as determined by Alloyd's year-end audit.

The Cross Motions for Summary Judgment

Summary judgment is appropriate when the pleadings and discovery show that "there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law." Fed. R. Civ. P.

56. The moving party bears the initial burden of establishing that no genuine issues of material fact exist. *Celotex Corp v. Catrett*, 477 U.S. 317, 321-22 (1986). The nonmoving party must respond to the moving party's claims by establishing specific facts that demonstrate a genuine issue that must be resolved at trial. *Id.* When assessing a motion for summary judgment, the court must accept as true the nonmoving party's evidence and draw all legitimate inferences in the nonmoving party's favor. *Valentine v. Joliet Township High School District*, 802 F.2d 981, 986 (7th Cir. 1986).

In their motion for summary judgment, the defendants raise several procedural arguments which they claim bar the plaintiffs from bringing this law suit. The defendants contend that Wind Point lacks standing to sue under Section 12(2) because it was not a purchaser of the securities at issue. Wind Point counters that it was the actual purchaser of Alloyd because it was the party who negotiated the purchase of Alloyd's stock and created Holdings for the sole purpose of consummating the sale.

Generally, only purchasers have standing to sue for violations of Section 12(2). *Greater Iowa Corp. v. McLendon*, 378 F.2d 783, 789-91 (8th Cir. 1967); *Dyer v. Eastern Trust and Banking Co.*, 336 F. Supp. 890, 910 (D. Me. 1971). Several courts have addressed the question of whether a party who creates a shell corporation to purchase another entity constitutes a purchaser for the purposes of establishing standing. The plaintiffs contend that this court should follow the court's decision in *H.B. Holdings Corp. v. Scovill Inc.* where the court determined that the plaintiff, who had established a shell corporation to purchase the defendant corporation, qualified as a purchaser with

standing to sue under Section 12(2). 1990 LW 37869 (S.D.N.Y. March 26, 1990). In *Scovill*, the court noted that the defendant understood that the plaintiff was the purchaser, the defendants had solicited the plaintiff as a purchaser before the shell corporation was created, the plaintiff submitted the bid that the defendant accepted, and after closing, the plaintiff was in control of the shell corporation. The court concluded that this evidence sufficiently established that the plaintiff was the actual party at risk in the transaction and therefore had standing to sue. *Id.*

This court is persuaded by the court's reasoning in *Scovill*. To hold that plaintiffs who are and were treated by all parties as the actual purchasers do not have standing merely because they did not sign the pertinent sale agreement would be to put form over substance. Although Wind Point did not sign the Agreement in this case, like the plaintiff in *Scovill*, Wind Point was the actual party at risk in the pertinent transaction and was treated as such by all involved parties. For example, before Holdings was created, Wind Point obtained a profile of Alloyd, inspected Alloyd's facilities, and sent a letter of interest to Alloyd. The defendants even acknowledged that in November 1991, they agreed with Wind Point to form a corporation to buy Alloyd. Furthermore, during the course of negotiations over the purchase price, Wind Point conducted due diligence. Then, when the defendants subsequently determined that the inventory estimates they had relied upon to establish a purchase price for Alloyd were inaccurate, they contacted Wind Point employees to inform them of the discrepancy. These

facts establish that Wind Point was and the defendants recognized Wind Point as the actual purchaser of Alloyd.

This determination also comports with the Tenth Circuit's decision in *Grubb v. Federal Deposit Insurance Corp.*, 868 F.2d 1151 10th Cir. 1989). In *Grubb*, the plaintiff and the director of Security National Bank ("SNB") formed a shell corporation to purchase all the shares of SNB from the First National Bank and Trust Company of Oklahoma City ("First National"). In determining that the plaintiff had standing to sue under the Securities Exchange Act,[1] the court noted that the defendant seller made misrepresentations during direct negotiations with the plaintiff, negotiations occurred before the shell corporation was even established, and the shell corporation was created for the sole purpose of facilitating the purchase. *Id.* at 1161-62. The court also noted that the plaintiff had personally guaranteed the shell corporation's loan to purchase the SNB. *Id.* The *Grubb* court's reliance on the facts that the defendant recognized the plaintiff as the purchaser and the plaintiff was the actual party at risk supports this court's determination that Wind Point has standing in the instant law suit.

The defendants suggest that this court should rely instead upon the court's determination in *Rayman v. Peoples Savings Corp.*, 735 F. Supp. 842 (N.D. Ill. 1990). In

---

[1] The *Grubb* court was faced with the question of whether the plaintiff had standing to sue under Section 10(b) of the Securities Exchange Act. The *Grubb* court's analysis is still applicable to the instant action because the same requirement that the plaintiff be a purchaser of the pertinent stocks arises under Section 10(b) as it does under Section 12(2).

Rayman, Peoples Savings Corporation ("PSC") created a shell corporation to purchase Peoples Bank of Savings. The Flanagans were principal shareholders of PSC. The question before the court was whether the Flanagans had standing to bring a counterclaim under Section 10(b) of the Securities Act. *Id.* at 844-45. Based upon the court's thorough consideration of the policies underlying Section 10(b), the court determined that it must employ a bright-line definition of a purchaser when determining whether a claimant has standing. *Id.* at 848. Since the court found that shareholders do not qualify as purchasers, it held that the Flanagans did not have standing to sue under Section 10(b). *Id.* at 851.

Contrary to the defendants' suggestion, this court declines to follow *Rayman*. This court finds that the *Rayman* court's reliance upon a strict, bright-line definition of a purchaser appears to conflict with the Seventh Circuit's analysis in *Norris v. Wirtz*. 719 F.2d 256 (7th Cir. 1983). In *Norris*, the Seventh Circuit determined that the plaintiff, the beneficiary of a trust which had sold certain stocks, had standing to sue under Section 10(b) and Rule 10b-5 of the Securities Exchange Act. In reaching this conclusion the court stated: "The broad proscription against fraud set forth in Section 10(b) and Rule 10b-5 is defeated in its remedial purposes by taking an unrealistic view of what is alleged to have happened in this case." *Id.* at 260 (citing *Herman & MacLean v. Huddleston*, 103 S.Ct. 683 (1983)). This statement, as well as the court's determination that the plaintiff beneficiary had standing to sue, suggests that the Seventh Circuit did not intend to employ a strict

definition of who constitutes a purchaser as the court in *Rayman* suggests.[2]

This court also declines to follow *Rayman* because we are not persuaded that the policy analysis relied upon in *Rayman* court is applicable to the instant law suit. As previously stated, the *Rayman* court based its determination that a bright-line rule should be employed upon its analysis of the policy considerations underlying Section 10(b). *See* 735 F. Supp. at 848. The defendants in this case have provided this court with no evidence suggesting that the policy concerns underlying Section 10(b) are identical to those under Section 12(2) or are otherwise relevant to this court's determination. Therefore, this court finds that Wind Point has standing to sue under Section 12(2).[3]

---

[2] The Seventh Circuit also stated that to grant standing to the plaintiff in this case would not threaten the concerns addressed by the standing requirement for Section 10(b) and Rule 10b-5. *Norris*, 719 F.2d at 259. Indeed, in support of this contention, the court cited *James v. Gerber Products Co.* for the proposition that "the courts have generally inclined to a logical and flexible construction of the term 'purchaser-seller' in order to accommodate the avowed purpose of § 10(b) of protecting the investing public and of ensuring honest dealings in securities transactions." *Id.*

[3] The fact that Wind Point was not the only shareholder of Holdings also does not affect this court's conclusion that Wind Point has standing to sue under Section 12(2). This court recognizes that the court in *City National Bank of Fort Smith, Arkansas v. Vanderboom* considered the fact that the plaintiffs were not the sole shareholders of the pertinent shell corporation when determining that the plaintiffs did not have standing to sue under Section 10(b). 422 F.2d 221 (8th Cir. 1970). However, this court is not persuaded that the fact that there were several shareholders

The defendants next contend that the plaintiffs' claims are timebarred. Section 13 of the Securities Exchange Act of 1933 requires plaintiffs to bring claims under Section 12(2) within "one year after the discovery of the untrue statement or omission, or after such discovery should have been made by the exercise of reasonable diligence." *DeBruyne v. Equitable Life Assurance Society of the United States*, 920 F.2d 457, 466 (7th Cir. 1990).

The parties agree that on February 8, 1990, McLean, now the President of Holdings, became aware of the shortfall in Alloyd's inventory. The parties also agree that McLean did not inform other officers of Holdings of the shortfall until February 12, 1990. The defendants contend that McLean's discovery of the discrepancy on February 8 started the running of the one year limitations period in this case. The plaintiffs counter that the statute of limitations period did not begin to run until February 12 when other Holdings officers learned about the inventory shortfall.

---

in Holdings other than Wind Point should prevent Wind Point from establishing standing in the instant case. In this case, Wind Point was the majority shareholder of Holdings and the other shareholders consisted of four of the five key management personnel from Alloyd. *See* Defendants' Statement of Material Facts at ¶¶ 17-18; Defendants' Motion for Summary Judgment at 5. The defendants also acknowledge that they intended to sell Alloyd to Holdings, "a company to be formed by Wind Point." Defendants' Statement of Material Facts at ¶ 15. In addition, unlike in *Vanderboom*, other evidence in this case suggests that Holdings was a conduit formed to purchase Alloyd. *See Id.* at 228.

Generally, a principal is charged with the knowledge of its agent acquired in the course of the principal's business. *First National Bank of Cicero v. Lewco Securities Corp.*, 860 F.2d 1407, 1417 (7th Cir. 1988). However, an exception to this rule has been carved out in cases where the agent's interests are shown to be adverse to those of his principal. *Id.* In such cases, it is presumed that such an agent is unlikely to fulfill his fiduciary duty of full disclosure to the principal. *Id.*; Restatement (Second) of Agency § 282(1); *Evanston Bank v. ContiCommodity Services, Inc.*, 623 F. Supp. 1014, 1036 (N.D. Ill. 1985).

Contrary to the defendants' suggestion, even though McLean had become the President of Holdings and Alloyd no longer existed, this court finds that McLean's interests were adverse to those of Holdings. As evidenced by the present case, the inventory shortfall at issue could result in McLean being held liable to Holdings. McLean could therefore have had a personal interest in not telling the other Holding officers about the shortfall. Since McLean's interests were adverse to Holdings, the knowledge he acquired about the shortfall on February 8, 1990 cannot be imputed to Holdings. The statute of limitations period began to run in this case on February 12, 1990, the date when other Holdings officers learned about the discrepancy. Since the plaintiffs filed their complaint on February 11, 1991, one day before the limitations period ran out, the plaintiffs' Section 12(2) claim is not timebarred as the defendants suggest.

The defendants further contend that the plaintiffs' Section 12(2) claim should be dismissed because this provision can only be applied to initial offerings. Although the case law is divided, the trend favors limiting Section

12(2) actions to purchasers in initial offerings. *See, e.g., Ballay v. Legg Mason Wood Walker, Inc.*, 925 F.2d 682 (3d Cir. 1991); *Pacific Dunlop Holdings, Inc. v. Allen & Company Inc.*, 1991 U.S. Dist. LEXIS 6748 (N.D. Ill. 1991); *Bank of Denver v. Southeastern Capital Group, Inc.*, 763 F. Supp. 1552 (D. Co. 1991); *T. Rowe Price New Horizons Fund, Inc. v. Preletz*, 749 F. Supp. 705 (D. Md. 1990); *Grinsell v. Kidder, Peabody, & Co.*, 744 F. Supp. 931 (N.D. Ca 1990).

This court is persuaded, most notably by the Third Circuit in *Ballay*, that Section 12(2) claims can only arise out of the initial stock offerings. *See* 925 F.2d 682. In a thorough and well-reasoned opinion, the *Ballay* court determined that the language and legislative history of Section 12(2), as well as its relationship to Section 17(a) and 10(b) within the schemes of the 1933 and 1934 Acts, compelled a finding that Section 12(2) only applies to initial offerings and not to after-market trading. *Id.* at 693. The one other court in this district faced with this issue has also agreed with the Third Circuit's analysis. *See Pacific Dunlop Holdings*, 1991 U.S. Dist. LEXIS 6748. Based upon the court's reasoning in *Ballay*, this court therefore concludes that application of Section 12(2) must be restricted to initial distributions.

As the plaintiffs argue, the legislative history of the 1933 Securities Exchange Act suggests that Section 12(2) can be applied to a redistribution of securities if "such redistribution takes on the characteristics of a new offering by reason of the control of the issuer possessed by those responsible for the offering." H.R. No. 85, 73d Cong., 1st Sess. 7 (1933); *Ballay*, 925 F.2d at 690. While the plaintiffs suggest that this language supports their argument that Section 12(2) is applicable, they have provided

this court with no evidence to support their claim that the sale at issue possesses the characteristics of a new offering. At most, the plaintiffs claim that the instant case involved the purchase of stock directly from the controlling shareholders rather than from a stockbroker as was the case in *Ballay*. This claim does not suffice to overcome the court's conclusion that Section 12(2) cannot be applied to this case because other evidence more strongly suggests that the transaction at issue in this case cannot be compared to an initial offering. For example, the parties agree that Alloyd was formed in 1961. *See* Defendants' Statement of Material Facts at ¶ 2. Hence, the transaction at issue in this case occurred approximately 30 years after the initial issuance of Alloyd's stock. *See Bank of Denver*, 763 F. Supp. at 1559. Also, unlike purchasers in most initial offerings, the purchasers in this case had direct access to financial and other company documents, and had the opportunity to inspect the seller's property.

Since the plaintiffs fail to provide this court with adequate evidence showing that the pertinent transaction is not comparable to an initial offering, this court finds that Section 12(2) cannot be applied to the instant case. The court therefore grants defendants' motion to dismiss plaintiffs' Section 12(2) claim.[4] The court also dismisses

---

[4] The defendants also contend that the plaintiffs cannot prove the substantive elements of a Section 12(2) claim. There is no need for this court to consider this argument since, upon review of the defendants' arguments, the court finds that these arguments will not affect our decision to grant defendants' motion for summary judgment because the plaintiffs cannot bring a claim under Section 12(2).

plaintiffs' state law breach of contract claim for lack of jurisdiction. Finally, the court denies plaintiffs' motion for summary judgment as moot.

Conclusion

For the reasons stated above, the court grants defendants' motion for summary judgment and denies plaintiffs' motion for summary judgment as moot.

ENTER:

Ann Claire Williams, Judge
United States District Court

Dated: May 29, 1992

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

ALLOYD CO., INC., a Delaware corporation, f/k/a Alloyd Holdings, Inc., and WIND POINT PARTNERS II, L.P., a Delaware limited partnership,	)	Case No. 91 C 889
Plaintiffs,	)	Judge Williams
v.	)	
ARTHUR L. GUSTAFSON, DANIEL R. McLEAN and FRANCIS I. BUTLER,	)	
Defendants.	)	

FIRST AMENDED COMPLAINT

Alloyd Co., Inc. ("New Alloyd") and Wind Point Partners II, L.P. ("Wind Point") (collectively "Plaintiffs"), as their First Amended Complaint against Arthur L. Gustafson ("Gustafson"), Daniel R. McLean ("McLean") and Francis I. Butler ("Butler") (collectively "Defendants"), state as follows:

NATURE OF THE CASE

1. This is an action for rescission, or in the alternative for money damages, arising from the sale of a business by Defendants. In negotiating the sale, Defendants represented and warranted that the financial statements provided to the purchaser, Alloyd Holdings, Inc. ("Holdings"), fairly presented the financial condition and results

of operations of the business. In fact, the financial statements materially overstated earnings and did not fairly represent the financial condition or results of operations of the business. As a result, Holdings substantially overpaid for the business. Defendants violated Section 12(2) of the Securities Act of 1933 ("Securities Act"), 15 U.S.C. § 771(2). Defendants also breached the terms of the Stock Purchase Agreement ("Purchase Agreement") entered into by Holdings and Defendants, because Defendants have refused to indemnify New Alloyd for the losses sustained as a result of their breaches of the representations and warranties.

JURISDICTION AND VENUE

2. This Court has subject matter jurisdiction over this action under 28 U.S.C. § 1331, Section 22(a) of the Securities Act, 15 U.S.C. § 77v(a), and pursuant to principles of supplemental jurisdiction, 28 U.S.C. § 1367(a).

3. Venue is proper in this district pursuant to Section 22(a) of the Securities Act, 15 U.S.C. § 77v(a), and under 28 U.S.C. § 1391(b). All Defendants live and transact business in this district, the offer and sale took place in this district, a substantial amount of New Alloyd's property is situated in this district, and a substantial part of the events or omissions giving rise to the claim occurred here.

4. In connection with the acts and conduct complained of herein, Defendants, directly and indirectly, used means and instrumentalities of interstate commerce, including interstate telephone facilities, the United States

Federal Reserve wire transfer facilities, and the United States mails.

5. New Alloyd is incorporated in the State of Delaware and has its principal place of business at 1401 Pleasant Street, DeKalb, Illinois. New Alloyd manufactures clear plastic blister packaging, heat seal equipment, and tooling for a variety of nonfood consumer product manufacturers in the United States and Canada. New Alloyd was formed as the result of the merger of Old Alloyd into Holdings.

6. Wind Point is a limited partnership organized under the laws of Delaware with its principal place of business at 1525 Howe Street, Racine, Wisconsin.

7. Gustafson resides at 40W011 Burlington Road, St. Charles, Illinois. He was the former President of the business that was sold, Alloyd Co., Inc. ("Old Alloyd"), an Illinois corporation. Gustafson owned approximately 85% of Old Alloyd's stock.

8. McLean resides at 311 Thornbrook, DeKalb, Illinois. He was the former Executive Vice-President of Old Alloyd and owned approximately 10% of its stock.

9. Butler resides at 259 Arlington, Elmhurst, Illinois. He was the former Vice-President of Old Alloyd and owned approximately 5% of its stock.

WIND POINT'S PURCHASE OF OLD ALLOYD

Negotiations

10. On or about August 1989, Wind Point entered into discussions with Defendants concerning the sale of

Old Alloyd. Defendants owned all of the issued and outstanding capital stock of Old Alloyd.

11. On or about October 17, 1989, Defendants signed a binding Letter Agreement ("Letter Agreement") with Wind Point in which Defendants agreed to sell, and Wind Point agreed to purchase, substantially all of the issued and outstanding capital stock of Old Alloyd. Under the terms of the Letter Agreement, the consideration was to consist of, among other things, cash, promissory notes and Wind Point's assumption and repayment of Old Alloyd's debt. Beginning on or about October 18, 1989, Defendants and Wind Point began negotiating the terms of the definitive Purchase Agreement. On or about November 14, 1989, Defendants and Wind Point executed an Amendment to the Letter Agreement.

12. On or about November 17, 1989, to facilitate the acquisition of Old Alloyd, Wind Point created Holdings, a Delaware corporation formed for the purpose of acquiring Old Alloyd.

13. Between November 14, 1989 and December 20, 1989, Defendants and their representatives negotiated with representatives of Wind Point regarding the terms and conditions of the Purchase Agreement, including the representations and warranties concerning Old Alloyd's financial statements. During this same time period, Defendants and Holdings discussed the financial performance of Old Alloyd and historical year-end adjustments to Old Alloyd's inventory figures. At these meetings, McLean represented that negative year-end adjustments to inventory historically had been about $200,000 or less.

14. On or about December 20, 1989, Defendants and Holdings executed the Purchase Agreement. A copy of the Purchase Agreement, not including the Schedules and Exhibits, is attached as Exhibit A.

15. The "Closing Date" was December 22, 1989. Defendants and Holdings executed all necessary documents on the Closing Date. Also on the Closing Date, the cash component of the purchase price paid for the stock and related non-compete agreements was wire transferred to a variety of sources, including the Defendants, Old Alloyd's lenders, Defendants' lenders and the escrow agent. Immediately following consummation of the transaction, Old Alloyd was merged into Holdings. Holdings subsequently changed its name to Alloyd Co., Inc. ("New Alloyd").

Holdings's Valuation of Old Alloyd

16. During negotiations between Defendants and Holdings, Defendants provided Holdings with historical financial data on Old Alloyd. Specifically, Defendants furnished Holdings with consolidated audited balance sheets, income statements, and audited consolidated statements of and sources and applications of funds, for the years 1984 through 1987. Defendants also furnished Holdings with Old Alloyd's 1988 balance sheet and income statement (including a consolidated budget for the fiscal year beginning January 1, 1989). Finally, Defendants furnished Old Alloyd's consolidated unaudited balance sheet and related statements of income for the ten months ended October 31, 1989 (the "Unaudited 1989 Financial Statement").

17. Holdings evaluated all of Old Alloyd's historical financial data. Based on its review of the data, Holdings priced Old Alloyd at a multiple of approximately 7.5 times projected "EBIT" for the year ended December 31, 1989. "EBIT," as used by Holdings and Old Alloyd, meant earnings before income taxes, interest, acquisition related expenses and excess officers' compensation.

18. Based on the Unaudited 1989 Financial Statement, projected 1989 EBIT was $4,881,000. The total consideration Holdings agreed to pay for the stock of Old Alloyd and related non-compete agreements was approximately $37.0 million.

Representations and Warranties

19. Defendants knew that the consideration Holdings was willing to pay for Old Alloyd was based explicitly and directly on projected 1989 EBIT and on the related growth trend of EBIT for the previous five years. Consequently, as an inducement for Holdings to enter into the Purchase Agreement, Defendants jointly and severally provided Holdings with representations and warranties concerning the financial condition and results of operations of Old Alloyd.

20. Among the representations and warranties in the Purchase Agreement were the following.

(a) *Financial Statements.* Defendants represented that the financial statements provided to Holdings, including, among other things, the Unaudited 1989 Financial Statement, "present fairly on a consolidated basis the Company's financial condition and related results of operations as of the times and for the periods referred to therein." Defendants also represented that the "Company's books of account and financial records fairly reflect the Company's income, expenses and liabilities." (Purchase Agreement Section 4D.)

(b) *No Material Adverse Changes.* Defendants represented that between the date of the Unaudited 1989 Financial Statement and the date of the Purchase Agreement, there were no material adverse changes in or material adverse events "affecting the business, financial condition, operating results, assets, operations or business prospects" of Old Alloyd. (Purchase Agreement Section 4I.)

(c) *Disclosure.* Defendants represented that there were no untrue statements of material fact or material omissions in the Purchase Agreement or any of the attached Schedules or exhibits, nor had Defendants failed to disclose to Holdings any material facts which would adversely affect Old Alloyd's "business, financial condition, operating results, assets, operations or business prospects." (Purchase Agreement Section 4Z.)

(d) *Closing Date.* Defendants represented that all of the representations and warranties in the Purchase Agreement and other documents delivered to Holdings were true and correct on December 20, 1989 and would be true and correct as of the Closing Date. (Purchase Agreement Section 4AA.)

21. On the Closing Date, Defendants delivered a certificate to Holdings reaffirming that the representations and warranties in the Purchase Agreement were true as of the Closing Date.

Plaintiffs Discover Old Alloyd Was Overvalued

22. New Alloyd retained KPMG Peat Marwick ("Peat Marwick") to perform an audit of Old Alloyd for the fiscal year ended December 31, 1989. Immediately after December 31, 1989, Peat Marwick began performing an audit of Old Alloyd for the fiscal 1989 year.

23. On or about February 12, 1990, New Alloyd received Peat Marwick's initial investigative findings, and information from McLean, relating to Old Alloyd's inventory figures. In reviewing the inventory information provided by Peat Marwick and McLean, New Alloyd learned that it was possible the Cost of Goods Sold figures set forth in the Unaudited 1989 Financial Statement were materially in error. Prior to receiving the information on February 12, 1990, Plaintiffs did not know, and could not by the exercise of reasonable diligence have known, that the Unaudited 1989 Financial Statement was materially in error.

24. On or about March 23, 1990, Plaintiffs received the preliminary results of Peat Marwick's audit. In reviewing those results, New Alloyd learned that the inventory figures on the Unaudited 1989 Financial Statement and the figure purportedly representing Old Alloyd's income from operations were so materially in error when the Purchase Agreement was signed (December 20, 1989) and on the Closing Date (December 22, 1989)

that the Unaudited 1989 Financial Statement did not present fairly Old Alloyd's financial condition and related results of operations.

25. Because projected 1989 EBIT was directly based on the income figures in the Unaudited 1989 Financial Statement, New Alloyd came to believe it had overpaid Defendants. The preliminary results of the audit indicated that actual fiscal 1989 EBIT was substantially less than the projection based on the Unaudited 1989 Financial Statement.

26. On or about March 23, 1990, New Alloyd made a written claim for indemnification, pursuant to the Purchase Agreement, against Defendants. That letter claimed that the Defendants had breached the representations and warranties referred to in Paragraph 20 above, which appear in the Purchase Agreement as Sections 4D, 4I, 4Z and 4AA.

27. On or about April 3, 1990 New Alloyd received Peat Marwick's final audited financial statements for Old Alloyd for the 1989 fiscal year. The final audited financial statements revealed that income from operations for 1989 was only $2,915,000, or $1,460,676 less than the annualized income from operations based on the ten-month figure stated in the Unaudited 1989 Financial Statement.

28. Based on the final audited statements, Plaintiffs determined that actual 1989 EBIT was $3,387,000, or $1,494,000 less than the projection based on the Unaudited 1989 Financial Statement.

29. On or about May 3, 1990, New Alloyd notified Defendants of the adjustments to the 1989 balance sheets.

New Alloyd forwarded a copy of Peat Marwick's final audited 1989 Balance Sheet to Defendants on or about May 9, 1990.

30. Had the true information on EBIT been known at the time of the transaction, Holdings would not have pursued the purchase of Old Alloyd because the acquisition would not have satisfied its customary investment criteria. Even assuming Holdings had chosen to ignore its investment criteria and pursue the acquisition, it would have applied a valuation multiple significantly lower than 7.5 times EBIT to the actual lower EBIT figure.

COUNT I

VIOLATION OF SECTION 12(2) OF THE SECURITIES ACT, 15 U.S.C. § 771(2)

31. Plaintiffs reallege and incorporate Paragraphs 1-30 as Paragraph 31 herein.

32. Defendants offered and sold to Holdings all the issued and outstanding capital stock of Old Alloyd. The capital stock of Old Alloyd constitutes a security as defined in the Securities Act.

33. In making their offer and sale of securities, Defendants used a means of communication in interstate commerce. Specifically, Defendants used the telephone wires, the United States Federal Reserve wire transfer facilities and United States mails.

34. The Purchase Agreement offered and confirmed the sale of Old Alloyd's capital stock to Holdings. Accordingly, the Purchase Agreement is a prospectus, as that term is defined in the Securities Act. Defendants also

orally made representations to Plaintiffs on numerous occasions to induce them to purchase the stock of Old Alloyd.

35. In both the Purchase Agreement and their oral communications, Defendants represented and warranted that, among other things, the Unaudited 1989 Financial Statement fairly and accurately presented the financial condition and results of operations of Old Alloyd. In fact, the Unaudited 1989 Financial Statement was materially misleading because actual 1989 EBIT was significantly lower than represented. Thus, Defendants made false and misleading statements of a material fact or omitted to state a material fact necessary to make the statements, in light of the circumstances under which they were made, not misleading.

36. Plaintiffs (and Holdings) did not know that Defendants' representations and warranties were untrue.

37. Defendants knew, or in the exercise of reasonable care could have known, that their representations and warranties were untrue.

38. Plaintiffs have been damaged by Defendants' misleading statements because New Alloyd substantially overpaid for Old Alloyd. New Alloyd stands ready to tender the shares at any time.

WHEREFORE, Plaintiffs pray that: (1) this Court enter judgment in their favor and against Defendants; (2) order that Plaintiffs' purchase of Old Alloyd be rescinded and that, upon tender of the shares, Defendants return to Plaintiffs the consideration paid, less any income

received; (3) award Plaintiffs their costs, including attorneys' fees; and (4) award Plaintiffs any other relief deemed just and equitable.

COUNT II
BREACH OF CONTRACT

39. New Alloyd realleges and incorporates Paragraphs 1-38 as Paragraph 39 herein.

40. The Purchase Agreement is a contract between New Alloyd (f/k/a Holdings) and Defendants covering the purchase and sale of Old Alloyd.

41. New Alloyd has performed all the obligations required of it by the Purchase Agreement.

42. Under Purchase Agreement Section 7B(a)(i), Defendants agreed to jointly and severally indemnify Holdings and hold it harmless against "any loss, liability, penalty, deficiency, damage, or expense (including reasonable legal expenses and costs)" arising from a breach by Defendants of their representations and warranties.

43. Holdings's right to indemnification under the Purchase Agreement is in addition to any other remedies Holdings may have against the Defendants at law or in equity for breach of the representations and warranties.

44. To facilitate indemnification under the Purchase Agreement, Holdings deposited $4,000,000 of the cash portion of the purchase price into an Escrow Fund. Under Purchase Agreement Section 7B(c)(ii), if the Escrow Fund was sufficient to satisfy a claim, Holdings was required, prior to exercising its other remedies, to make a claim against the Escrow Fund in accordance with the terms of

the Escrow Agreement. The Escrow Agreement provides for arbitration of any disputed claims to the Escrow Fund.

45. Purchase Agreement Section 7B(c)(ii) also provides that, to the extent the Escrow Fund is insufficient to satisfy any loss, Holdings may simultaneously exercise its other remedies against Defendants.

46. On or about March 23, 1990, new Alloyd made a claim against the $4,000,000 Escrow Fund. On or about April 11, 1990, Defendants objected to payment of New Alloyd's claim from the Escrow Fund. Accordingly, New Alloyd has demanded arbitration of its claim to the Escrow Fund.

47. However, because New Alloyd's losses far exceed the $4,000,000 in the Escrow Fund, New Alloyd has demanded that Defendants indemnify them for any loss in excess of $4,000,000, pursuant to the terms of the Purchase Agreement.

48. Defendants have refused to honor their obligation in Purchase Agreement Section 7B(a) to indemnify New Alloyd for "any loss, liability, penalty, deficiency, damage or expense (including reasonable legal expenses and costs)" which New Alloyd sustained as a result of Defendants' breach of their representations and warranties. Accordingly, Defendants have breached the contract.

49. New Alloyd has been damaged by Defendants' breach.

WHEREFORE, New Alloyd prays that this Court: (1) enter judgment in its favor and against Defendants; (2) award it damages for Defendants' breach of contract, in

an amount to be proven at trial, plus legal expenses and costs; and (3) award it any other relief deemed just and equitable.

DATED: March 20, 1991 Respectfully submitted,

/s/ Brian D. Sieve
One of the Attorneys for
Plaintiffs Alloyd Co., Inc.
and Wind Point Partners
II, L.P.

Robert J. Kopecky, Esq.
Brian D. Sieve, Esq.
KIRKLAND & ELLIS
200 East Randolph Drive
Chicago, Illinois 60601
(312) 861-2000

PACIFIC DUNLOP HOLDINGS INCORPORATED, a Delaware Corporation, Plaintiff-Appellant,

v.

ALLEN & COMPANY INCORPORATED, a New York Corporation, Defendant-Appellee.

No. 91-2346.

United States Court of Appeals,
Seventh Circuit.

Argued Sept. 11, 1992.
Decided May 7, 1993.

Buyer of stock brought suit against seller alleging fraud in private stock purchase agreement. The United States District Court for the Northern District of Illinois, James B. Zagel, J., summarily dismissed complaint, and buyer appealed. The Court of Appeals, Manion, Circuit Judge, held that: (1) section of Securities Act prohibiting fraud in a prospectus applies to secondary market transactions, and (2) private stock purchase agreement was a "prospectus," within meaning of section of Securities Act prohibiting fraud in a prospectus.

Reversed and remanded.

Peter J. Meyer, Michael J. Koenigsknecht (argued), Andrew C. Spiropoulos, John W. Raihala, Gardner, Carton & Douglas, Chicago, IL, for plaintiff-appellant.

Derke J. Price, Nick J. DiGiovanni, Lord, Bissell & Brook, Chicago, IL, James C. McMillin (argued), Kevin J. Toner, Werbel, McMillin & Carnelutti, New York City, for defendant-appellee.

Before BAUER, Chief Judge, MANION, Circuit Judge, and MOODY, District Judge.*, **

MANION, Circuit Judge.

This case presents a single issue of law: the scope of section 12(2) of the Securities Act of 1933 (1933 Act), 48 Stat. 74, as amended, 15 U.S.C. § 771, as it involves civil fraud in a security transaction.[1] On October 1, 1987 Pacific Dunlop Holdings Inc. ("Pacific") entered into a stock purchase agreement with GNB Holdings Inc. ("GNB") and its other shareholders, Allen & Company Incorporated ("Allen"), Daniel E. Heffernan and thirteen other individuals. The defendants in this case, Allen, an investment banking firm, owned approximately 20 percent of the stock, and Heffernan owned 6.7 percent.[2]

---

* Honorable James T. Moody, District Judge for the Northern District of Indiana, is sitting by designation.

** This opinion has been circulated pursuant to Circuit Rule 40(f) among the judges of this court in regular active service. A majority did not favor a rehearing en banc (Circuit Judge Kenneth F. Ripple voted to rehear en banc) on the question of a conflict with Ballay v. Legg Mason Wood Walker, Inc., 925 F.2d 682 (3d Cir.), cert. denied, ___ U.S. ___, 112 S.Ct. 79, 116 L.Ed.2d 52 (1991).

[1] The 1933 Act is codified in 15 U.S.C. §§ 77a et seq. The citations in the opinion will refer to the more familiar sections of the 1933 Act, rather than to the particular sections of the United States Code.

[2] Pacific Dunlop originally brought this appeal against Allen and Heffernan. During the pendency of the appeal Pacific and Heffernan agreed to settle their dispute. On February 18, 1993 we granted Pacific's motion to dismiss Heffernan pursuant to Fed.R.App.P. 42(b). Allen remains as defendant-appellee.

Neither defendant is considered a management shareholder. A few months earlier GNB filed a registration statement with the Securities Exchange Commission in order to make an initial public offering of 5,800,000 shares of common stock, including some stock owned by Heffernan. No securities were ever sold pursuant to the registration statement. GNB abandoned the public offering once it entered into the private stock purchase agreement with Pacific, although the agreement did warrant and represent the truthfulness of the information in the registration statement.

Pacific's purchase of GNB brought its ownership to approximately 92 percent of the outstanding common stock for a total cost of $670 million.[3] GNB is a holding company whose subsidiaries engage in the manufacture and sale of industrial and lead acid batteries and the recovery, smelting and sale of lead. In pertinent part the stock purchase agreement represented that GNB and its subsidiaries were in compliance with environmental laws and regulations, were not subject to any pending or threatened governmental investigation and had disclosed all liabilities or obligations. But in reality, GNB was exposed to and now faces extensive environmental claims, liabilities regarding a government services contract, and occupational disease claims. In part to avoid the liabilities and to expunge itself from the plethora of problems GNB faces, Pacific seeks to rescind the deal.

---

[3] After the purchase GNB's name was changed to Pacific Dunlop GNB Corporation, the sole common shareholder of GNB Incorporated, which in turn maintains a wholly-owned subsidiary, GNB Industrial Battery Company.

Allen is not interested; it prefers to keep the money rather than regain the stock.

Pacific's complaint asserts that Allen omitted material facts that rendered its representations in the stock purchase agreement false and misleading, constituting fraud in violation of the Securities Act, section 12(2), and the Illinois Securities laws.[4] Allen moved to dismiss the complaint for failing to state a claim upon which relief could be granted. The district court summarily dismissed the complaint, relying upon the Third Circuit opinion in Ballay v. Legg Mason Wood Walker, Inc., 925 F.2d 682 (3d Cir.), cert. denied, ___ U.S. ___, 112 S.Ct. 79, 116 L.Ed.2d 52 (1991).

Section 12(2) prohibits fraud in a prospectus. However, there are many possible interpretations of "prospectus." Section 2(10) contains an explicit definition of prospectus; however, this definition may not control if the context of the securities laws and their legislative history require otherwise. Pacific wants the section 2(10) definition to apply in this case. Because of its broad wording, the definition of prospectus would include the

---

[4] This case is among several involving these transactions. Heffernan, as a former director of GNB, has sued Pacific for indemnification. See Heffernan v. Pacific Dunlop GNB Corp., 965 F.2d 369 (7th Cir.1992). Pacific separately sued the management shareholders pursuant to section 10(b) of the 1934 Act. See Pacific Dunlop Holdings Inc. v. Robert F. Barosh, No. 91-C-0002, 1991 WL 348494 (N.D.Ill.1991). Two of the management shareholders, in turn, have sued Pacific for breach of contract because Pacific has not paid the final balance due of nearly $23 million. See Stanley N. Gaines v. Pacific Dunlop Holdings Inc., No. 91-C-0025 (N.D.Ill.1991).

stock purchase agreement and provide Pacific relief. Allen, however, wants a more narrow definition, arguing section 12(2) does not apply to secondary market transactions. Case law provides authority on each side of the dispute. Ultimately, we conclude that Pacific has a cause of action, based on the text of the 1933 Act, its legislative history, and the impact of section 12(2) on similar fraud provisions in the security laws.

I. Conflict of Authority

The 1933 Act was passed by Congress during an era in our country's history marked by grave concern over the securities market. Since that time numerous district courts have applied section 12(2) of the 1933 Act to similar facts yielding different results. E.g., Bank of Denver v. Southeastern Capital Group, Inc., 763 F.Supp. 1552, 1558-59 (D.Colo.1991) (and cases cited therein); see 17A J. William Hicks, Civil Liabilities: Enforcement and Litigation Under the 1933 Act, § 6.01, pp. 12-34 (1992). In Ballay, which the district court relied on in this case, investors had purchased outstanding securities of Wickes Corporation from stockbrokers employed by Legg Mason. 925 F.2d at 684. A jury found for the investors and against the brokerage firm for oral misrepresentations concerning the actual value of the stock. Id. at 686. The Third Circuit reversed, holding that section 12(2) applies only to initial distributions, not to after-market trading, based on "the language and legislative history of section 12(2), as well as its relationships to sections 17(a) and 10(b) within the scheme of the 1933 and 1934 Acts." Id. at

693,[5] Cf., Louis Loss, Commentary, The Assault on Securities Act Section 12(2), 105 Harv.L.Rev., 908 (1992).

Although the Supreme Court has not specifically addressed whether section 12(2) applies solely to initial offerings, the Supreme Court assumed to the contrary in Wilko v. Swan, 346 U.S. 427, 74 S.Ct. 182, 98 L.Ed. 168 (1953). In Wilko, investors sued their brokerage firm, Hayden, Stone & Co., pursuant to section 12(2) for misrepresentations concerning the value of the common stock of Air Associates, Incorporated (based on a merger contract with Borg Warner Corporation), and for omitting to state that an Air Associates director was also selling his stock. Id. at 429, 74 S.Ct. at 183-84. The brokerage firm moved to stay the district court proceedings pending arbitration in accordance with their margin agreements with the investors. The district court denied the motion, concluding that arbitration was contrary to the remedies afforded by the 1933 Act. Wilko v. Swan, 107 F.Supp. 75, 79 (1952). The Second Circuit reversed, holding that the congressional policies under the United States Arbitration Act permitted arbitration of the dispute, overriding the 1933 Act. Wilko v. Swan, 201 F.2d 439, 445 (1953). The

---

[5] A primary distribution is a public offering made on behalf of the issuer. The proceeds realized from the offering will . . . be available to the issuer to be used for corporate purposes. A secondary distribution broadly defined is one made on behalf of some person or persons other than the issuer. 3A Harold S. Bloomenthal, Securities and Federal Corporate Law, § 6.03, p. 4 (1988). "Trading in securities involves transactions by someone other than an issuer; it assumes that the securities are presently outstanding and are being bought and sold in the organized securities market." Id. at § 6.04, p. 5.

Supreme Court reversed the Second Circuit, holding that an arbitration agreement could not waive the provisions of section 12(2) of the 1933 Act, notwithstanding the Arbitration Act. Wilko v. Swan, 346 U.S. at 438, 74 S.Ct. at 188-89.

Although in Wilko the arbitration provision of the margin agreements between the investors and their brokerage firm was the only issue raised in the motion to dismiss the complaint,[6] the posture of the case included the facts that no registration statement had been filed; and the securities involved common stock on the aftermarket, not an intial offering. On these facts the Supreme Court stated:

> In response to a Presidential message urging that there be added to the ancient rule of caveat emptor the further doctrine of "let the seller also beware," Congress passed the Securities Act of 1933. Designed to protect investors, the Act requires issuers, underwriters, and dealers to make full and fair disclosure of the character of securities sold in interstate and foreign commerce and to prevent fraud in their sale. To effectuate this policy, § 12(2) created a special right to recover for misrepresentation which differs substantially from the common-law action

---

[6] On remand from the Supreme Court, the jury found the securities were exempted from the registration requirements. Wilko v. Swan, 127 F.Supp. 55, 57 (1955). The district court granted a new trial on the section 12(2) claims and rejected the brokerage firm's argument that the 1933 Act was not intended to apply to transactions on a national securities exchange. Id. Thus, the district court's interpretation of the Supreme Court case in Wilko is consistent with the conclusion we reach today.

> in that the seller is made to assume the burden of proving lack of scienter.

Wilko, 346 U.S. at 430-31, 74 S.Ct. at 184-85 (emphasis added; footnotes omitted). Although dicta, the Supreme Court's recognition that section 12(2) applies to dealers[7] stands in opposition to the Third Circuit's holding in Ballay, 925 F.2d 682. This reasoning survived Rodriguez De Quijas v. Shearson/American Express, Inc., 490 U.S. 477, 109 S.Ct. 1917, 104 L.Ed.2d 526 (1989).[8]

Also contrary to the Third Circuit's holding in Ballay stands the Tenth Circuit's opinion in Woodward v. Wright, 266 F.2d 108 (1959). Wright had assigned the majority of his interest in an oil and gas lease to Forrest and Hanna, who decided to sell the lease to Woodward and some fellow businessmen. The district court found that the sellers had mailed a prospectus to the purchasers that contained material false statements, but that the transaction did not violate sections 12(1)-(2). Id. at 112. The Tenth Circuit first ruled that the oil and gas lease involved a security sale within the meaning of the 1933

---

[7] The 1933 Act defines a "dealer" to include a broker. Section 2(12). Contrary to the Wilko and Ballay decisions which involved brokers, the present case involves a direct sale between the stock owners and purchasers pursuant to a stock purchase agreement. We do not need to address any question under section 12(2) as to who may be liable; rather, we need only address whether the scope of section 12(2) liability includes the type of securities sold in this case.

[8] The Supreme Court in Rodriguez De Quijas overruled Wilko; parties may now agree to arbitrate claims under the Securities Act, notwithstanding the waiver provision of section 14. Rodriguez De Quijas, however, did not comment on section 12(2).

Act. Id. at 114. Second, "[t]he whole transaction was a closely knit arrangement among friends and acquaintances, and was conducted on a personal basis. All of the purchasers apparently entered into the transaction with sophisticated discernment." Id. at 115 (emphasis and citation omitted). Thus, the court concluded that the single transaction was not a public offering and did not violate section 12(1)[9] by failing to file a registration statement. Finally, on the question of section 12(2) liability, the Tenth Circuit reversed the district court in favor of the purchasers.

> [T]he [s]ection [12(2)] remedy is applicable to the sale of all securities (with exceptions not here material) whether exempt from the registration requirements or not, or whether the sellers were issuers for the purpose of public offering or not.

Woodward, 266 F.2d at 116. As in the Wilko decision, in Woodward neither the parties nor the court directly addressed whether section 12(2) applied solely to initial offerings. Nevertheless, the Tenth Circuit upheld a section 12(2) claim in a case where no registration statement was required and the sale of the securities involved a secondary market transaction.[10] The Tenth Circuit thus assumes a different application of section 12(2) than that required of the Third Circuit in Ballay.

---

[9] The court identified sections 12(1-2) as sections 9(1-2), reflecting the numerical change of the 1954 amendments. Woodward, 266 F.2d at 111.

[10] The Tenth Circuit has since followed its Woodward decision, applying the same analysis to similar facts. Gilbert v. Nixon, 429 F.2d 348, 356-59 (1970).

Likewise, the First Circuit has allowed a section 12(2) claim involving a secondary market transaction. In Cady v. Murphy, 113 F.2d 988, 989 (1st Cir.), cert. denied, 311 U.S. 705, 61 S.Ct. 175, 85 L.Ed. 458 (1940), a securities broker had persuaded Murphy to purchase voting trust certificates of South American Utilities Corporation, which were part of a block of shares that had previously been held by E.E. Smith & Company. The court noted indirectly that the sale was not required to be registered, and held that section 12(2) imposed liability "for misrepresentations not only upon principals, but also upon brokers when selling securities owned by other persons." Id., 113 F.2d at 990. As in the Wilko and Woodward decisions, neither the parties nor the court directly addressed whether section 12(2) applied solely to initial offerings. But in Cady the First Circuit did uphold a section 12(2) claim in a case where no registration statement was required and the sale of the securities involved outstanding stock. Thus, the Third Circuit's opinion in Ballay stands in opposition to what the First and Tenth Circuits have already permitted. For the reasons which follow, we depart from the Third Circuit and hold that section 12(2) includes secondary market transactions.

II. The Text of the 1933 Act

"The starting point in every case involving construction of a statute is the language itself." Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 756, 95 S.Ct. 1917, 1935, 44 L.Ed.2d 539 (1975). Section 12 states that any person who

(1) offers or sells a security in violation of section 5, or

(2) offers or sells a security (whether or not exempted by the provisions of section 3, other than paragraph (2) of subsection (a) thereof), by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission, shall be liable to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security.

The parties admit that their stock purchase agreement is not exempted by the provisions of section 3(a)(2) and that they have availed themselves of means and instruments in interstate commerce and the mails. The parties would leave for trial whether the stock purchase agreement actually contains a misstatement or omission of material fact. For purposes of the motion to dismiss, the parties only dispute whether their stock purchase agreement was "by means of a prospectus or oral communication" and

whether Congress intended that the 1933 Act should apply in the present case.[11]

Specifically, Pacific argues that the stock purchase agreement in this case falls under the definition of a prospectus in section 2(10) of the 1933 Act because the stock purchase agreement was a communication of an offer to sell securities. Allen responds that the agreement does not fit within the definition. It argues that section 2 begins with the phrase "When used in this title, unless the context otherwise requires . . . ," and that the context of section 12(2) requires a different definition than section 2(10). Finally, Allen argues that the legislative history illustrates that Congress intended the civil fraud remedy of section 12(2) to encompass only initial offerings.

A. The section 2(10) definition of prospectus.

Section 2 of the 1933 Act defines certain terms of art ("prospectus", "sale", "offer" and "security") very broadly. A prospectus includes a variety of communications, and specifically exempts others. The prospectus also must involve the offer or sale of a security. We begin with a look at each of these key definitions.

---

[11] Allen also moved the district court to dismiss the complaint for failure to plead fraud with particularity, failure to allege Allen itself (rather than the corporation and the management shareholders) made any false representations in the stock purchase agreement and failure to allege the plaintiffs' reasonable efforts in bringing the action within the statute of limitations period. Allen may again raise these arguments before the district court. They were neither briefed nor argued to this court, and we take no position on their merit.

(1) The term "security" means any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, any put, call, straddle, option, or privilege on any security,. . . .

* * *

(3) The term "sale" or "sell" shall include every contract of sale or disposition of a security or interest in a security, for value. The term "offer to sell", "offer for sale", or "offer" shall include every attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security, for value. . . .

* * *

(10) The term "prospectus" means any prospectus, notice, circular, advertisement, letter, or communication, written or by radio or television, which offers any security for sale or confirms the sale of any security; except that

(a) a communication sent or given after the effective date of the registration statement (other than a prospectus permitted under subsection (b) of section 10) shall not be deemed a prospectus if it is proved that prior to or at the same time with such communication a written prospectus meeting the requirements of subsection (a) of section 10 at the time of such communication was sent or given to the person to whom the communication was made, and

> (b) a notice, circular, advertisement, letter, or communication in respect of a security shall not be deemed to be a prospectus if it states from whom a written prospectus meeting the requirements of section 10 may be obtained, and, in addition, does no more than identify the security, state the price thereof, state by whom orders will be executed, and contain such other information as the Commission, by rules or regulations deemed necessary or appropriate in the public interest and for the protection of investors, and subject to such terms and conditions as may be prescribed therein, may permit.

Without citation, Allen argues that the stock purchase agreement in this case does not fit within the definition of prospectus in section 2(10). In its brief Allen claims that "A privately negotiated contract is simply not a communication, such as those listed in section 2(10), which is designed to entice buyers, . . . [nor does it] 'confirm[ ] the sale of any security.' " From Allen's standpoint, this is an optimistically narrow reading. Pacific properly cites Byrnes v. Faulkner, Dawkins & Sullivan, the breadth of which underscores the section 2(10) definition:

> In 1941, . . . the SEC's general counsel issued an opinion to the effect that the term "prospectus" included "within its meaning an ordinary confirmation," as well as "every kind of written communication . . . which constitutes a contract of sale or disposition of a security for value." Securities Act Release No. 2623 (1941), reprinted in 11 Fed.Reg. 10964 (1946). A 1954 statutory amendment incorporated this opinion in substance into the language of Section 2(10) of the 1933 Act as quoted above; the congressional reports explicitly referred to the 1941 opinion

> and stated that the amendment was adopted in order to avoid any implied repeal of "settled interpretations" of the original text of Section 2(10). S.Rep. No. 1036 at 12, H.R.Rep. No. 1542 at 21, 83d Cong., 2d Sess. (1954), U.S.C.C.A.N. 1954, p. 2973.

550 F.2d 1303, 1309 (2d Cir.1977). A prospectus thus includes a contract of sale or any other kind of written communication that disposes of a security. The stock purchase agreement in this case evidences that Allen would sell and that Pacific would purchase over six million shares of stock. And the agreement represents information given and received by all parties which led to this present dispute. Thus, Allen cannot seriously deny that the stock purchase agreement was a written communication involving the sale of securities. See Sanders v. John Nuveen & Co., 619 F.2d 1222, 1225 (7th Cir.1980) (finding commercial paper reports constituted a prospectus), cert. den. sub nom., 450 U.S. 1005, 101 S.Ct. 1719, 68 L.Ed.2d 210 (1981); accord Short v. Belleville Shoe Mfg. Co., 908 F.2d 1385, 1390 (7th Cir.1990) (a prospectus includes "materially incorrect or misleading selling literature."), cert. denied, ___ U.S. ___, 111 S.Ct. 2887, 115 L.Ed.2d 1052 (1991).

Because the 1933 Act contains only one explicit definition of prospectus, one conclusion would be that the term prospectus means the same throughout the 1933 Act. This would boost Pacific's argument that section 12(2) incorporates the section 2(10) definition. However, if the 1933 Act contemplates more than one definition of prospectus, Pacific's argument of whether a certain definition applies is weakened by asking which definition

applies. See Balley, 925 F.2d at 688-89. A comparison with the definition of "registration statement" helps to provide guidance. The 1933 Act primarily deals with three areas: the registration statement, the prospectus, and fraud. The section defining registration statement (Section 2(8)) incorporates section 6 as follows:

> The term "registration statement" means the statement provided for in section 6, and includes any amendment thereto and any report, document, or memorandum filed as part of such statement or incorporated therein by reference.

But section 2(10), which defines "prospectus," does not confine itself to "the statement provided for in section 10," or other such language. This permits the inference that section 10 involves only one type of prospectus. The inference finds support in the definitional section of prospectus, because certain communications are exempted from the term "prospectus" where the communication includes the delivery of a section 10 prospectus or states from whom such a document may be obtained. Section 2(10)(a-b). Thus, certain communications could be classified as prospectuses under section 2(10) without complying with section 10.

Section 10(d) provides the best indication that no single definition similarly applies throughout the 1933 Act. In this section the Commission is given the

> authority to classify prospectuses [under section 10] according to the nature and circumstances of their use or the nature of the security, issue, issuer, or otherwise, and, by rules and regulations and subject to such terms and conditions

> as it shall specify therein, to prescribe as to each class the form and contents which it may find appropriate and consistent with the public interest and the protection of investors.

Thus, the 1933 Act contemplates many definitions of a prospectus. Section 2(10) gives a single, broad definition; section 10(a) involves an isolated, distinct document – a prospectus within a prospectus; section 10(d) gives the Commission authority to classify many. See 17 C.F.R. §§ 230.134, 230.153, 230.420-230.432. Which definition did Congress contemplate in section 12(2)? The definitional section 2 begins with the phrase "When used in this title, unless the context otherwise requires. . . . " (Emphasis added.) This leads to an analysis of the context of a prospectus and whether section 12(2) requires a definition of prospectus contrary to the broad definition of section 2(10).

B. The context of prospectus.

In Rowland v. California Men's Colony, ___ U.S. ___, 113 S.Ct. 716, 121 L.Ed.2d 656 (1993), an inmate association sued various prison officials under 42 U.S.C. § 1983. The issue was whether an association fell under the definition of person in 28 U.S.C. § 1915(a), in order to proceed in forma pauperis. The Court focused on the definition of "person" in the Dictionary Act, 1 U.S.C. § 1. That section began with the phrase: "[i]n determining the meaning of any Act of Congress, unless the context indicates otherwise." Rowland, ___ U.S. at ___, 113 S.Ct. at 720 (emphasis added). Although the present case involves the work "requires" rather than "indicates," the Court's discussion of the work "context" is particularly instructive.

> "Context" here means the text of the Act of Congress surrounding the word at issue, or the texts of other related congressional Acts, and this is simply an instance of the word's ordinary meaning: "[t]he part or parts of a discourse preceding or following a 'test' or passage or a word, or so intimately associated with it as to throw light upon its meaning." Webster's New International Dictionary 576 (2d ed. 1942). While "context" can carry a secondary meaning of "[a]ssociated surroundings, whether material or mental," ibid., we doubt that the broader sense applies here. The Dictionary Act uses "context" to give an instruction about how to "determin[e] the meaning of a[n] Act of Congress," a purpose suggesting the primary sense. If Congress had meant to point further afield, as to legislative history, for example, it would have been natural to use a more spacious phrase, like "evidence of congressional intent," in place of "context."

Id., ___ U.S. at ___, 113 S.Ct. at 720. The 1933 Act does not define "context." Pacific argues that the context of prospectus when used in section 12(2) concerns only the language in that particular section. See American Bankers Ass'n v. S.E.C., 804 F.2d 739, 753-55 (D.C.Cir.1986). As a general rule, "[t]he context of a particular sentence or clause in a statute . . . comprises those parts of the text which immediately precede and follow it." Black's Law Dictionary 320 (6th ed. 1990). Allen, on the other hand, argues that the context of prospectus concerns the scope of the entire 1933 Act, including its legislative history. If prospectus is defined in such a broad context, Allen asserts that the totality of the 1933 Act and its legislative history would demonstrate that section 12(2) was not

intended to include secondary market transactions. An overview of the 1933 Act will help provide guidance.

The 1933 Act consists of twenty-six sections and two schedules. Section 2 merely defines the majority of important terms. Section 3 lists specific exemptions to which the Act will generally not apply, including securities classified as reserved, and securities issued by the federal or state governments, banks, savings and loan associations, non-profit organizations, certain railroad trusts, bankruptcy certificates and insurance policies. Section 4 exempts certain transactions from the requirement that a registration statement be effective before selling the securities. Section 5 details the prohibitions where a registration statement has not become effective. Section 7 states the information required in the registration statement and accompanying schedules. Section 10 details the information required in a prospectus. Section 11 provides for civil liabilities for false information in any part of the registration statement, describing who may be sued, the shifting burdens of proof, the standard of negligence and the calculation of damages. The section we are most concerned with here, section 12, quoted supra, provides for civil liability for selling a security without an effective registration statement or for false information in a "prospectus or oral communication." Section 13 provides specific statute of limitations periods for the civil liability provisions of sections 11 and 12. Section 17 is a catch-all provision that makes fraudulent interstate security transactions unlawful. Section 24 makes a willful violation of any of the foregoing sections a criminal matter, involving a fine of not more than $10,000 or imprisonment of not more than five years or both.

The Third Circuit found the structure of the 1933 Act particularly instructive:

> Section 12(2) follows section 11 and section 12(1), which govern the registration of securities and create civil liability for sales of unregistered securities, respectively, and appears before section 13, which provides the statute of limitation for both sections 11 and 12. All of these sections deal with initial distributions. 15 U.S.C. §§ 77k, 771(1). Congress' placement of section 12(2) squarely among the 1933 Act provisions concerned solely with initial distributions of securities indicates that it designed section 12(2) to protect buyers of initial offers against fraud and misrepresentation.[12]

---

[12] The Third Circuit states that sections 11, 12(1) and 13 are "concerned solely with initial distributions of securities." Ballay, 925 F.2d at 691. This is not "solely" the case. See, e.g., Byrnes v. Faulkner, Dawkins & Sullivan, 550 F.2d 1303, 1307 (2d Cir.1977) (involving a registered secondary distribution). Sections 11 and 12(1) reference registration statements. They do not even mention language such as "initial" or "secondary". For example, registration statements are required in public offerings; certain private offerings are exempt. Section 4(2). The public/private and initial/secondary are two entirely different questions. As a general rule, a seller that publicly offers stock must register the security, whether the sale involves an initial issue or a secondary market transaction. Likewise, a qualified private security sale would be exempt from sections 5 and 12(1), whether the sale involved an initial issue or a secondary market sale. Telling the practical difference between the two can also prove difficult. Barnes v. Osofsky, 373 F.2d 269, 272-73 (2d Cir.1967). With respect to issuers, underwriters or dealers, all securities must be registered, again notwithstanding whether the sale involves an initial issue or a secondary market transaction. Section 4(1).

Ballay, 925 F.2d at 691. The 1933 Act is primarily concerned with only two documents – registration statements and prospectuses. They are dealt with in that order: Section 2 defines a registration statement (2(8)) and then a prospectus(2(10)). Section 6 details the registration statement and section 10 the prospectus. Section 11 applies to fraud in the registration statement and section 12 applies to fraud in the prospectus. The Third Circuit focused on this structure as the "context [that] otherwise requires" a prospectus to be confined to initial distributions. Section 2. We do not read the word "context" as broadly. Prior to Ballay, neither had the Third Circuit. Ruefenacht v. O'Halloran, 737 F.2d 320, 330-32 (3d Cir.1984), aff'd sub nom. 471 U.S. 701, 105 S.Ct. 2308, 85 L.Ed.2d 708 (1984). See Ernst & Ernst v. Hochfelder, 425 U.S. 185, 200, 96 S.Ct. 1375, 1384, 47 L.Ed.2d 668 (1976).

> The ascertainment of congressional intent with respect to the scope of liability created by a particular section of the Securities Act must rest primarily on the language of that section. The broad remedial goals of the Securities Act are insufficient justification for interpreting a specific provision "more broadly than its language and statutory scheme reasonably permit." We must assume that Congress meant what it said.

Pinter v. Dahl, 486 U.S. 622, 653, 108 S.Ct. 2063, 2081-82, 100 L.Ed.2d 658 (1988) (emphasis added; citations omitted). The structure of the entire 1933 Act cannot qualify as the context in which a prospectus should be defined. Such an approach would result in an entirely new definition in the place of section 2(10). Also, nothing in the structure of the 1933 Act requires a different definition of prospectus in section 12(2) than that contained in section

2(10). Thus, we confine our inquiry of the context of the word "prospectus" to the language of section 12. Rowland, ___ U.S. at ___, 113 S.Ct. at 720.

Section 12(1) of the Act specifically applies to a person who offers or sells a security in violation of section 5. In pertinent part, section 5 states that

> (a) Unless a registration statement is in effect as to a security, it shall be unlawful for any person, directly or indirectly –
>
> (1) to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to sell such security through the use or medium of any prospectus or otherwise; . . .
>
> (c) It shall be unlawful for any person, directly or indirectly, to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to offer or to sell or offer to buy through the use or medium of any prospectus or otherwise any security, unless a registration statement has been filed as to such security. . . .

By combining sections 5 and 12(1), the general rule is that a person may not offer or sell a security by means of "any prospectus or otherwise" without filing a registration statement. See A.C. Frost & Co. v. Coeur D'Alene Mines Corp., 312 U.S. 38, 41-42, 61 S.Ct. 414, 416, 85 L.Ed. 500 (1941). This would imply that a prospectus cannot exist without a registration statement. But this implication is not necessarily true.

The exemptions to section 5 include approximately twelve classes of securities listed in section 3 and the six

classes of transactions listed in section 4. If a security transaction is exempted under sections 3 or 4, a person will not incur section 12(1) liability pursuant to section 5. The question is whether these same exemptions apply to section 12(2).[13] Section 3 begins with the phrase "Except as hereinafter expressly provided." Section 12(2) expressly provides that fraud in a prospectus is actionable, "whether or not exempted by the provisions of section 3," unless the security falls under section 3(a)(2) (dealing only with securities issued by the federal and state governments and banks). Thus, only one of twelve classifications of securities exempted under section 3 is not actionable for a violation under section 12(2). As a result, section 12(2) applies to a much broader range of securities than sections 5 or 12(1). Section 4 begins with the phrase "The provisions of section 5 shall not apply to. . . . " If Congress had wanted the section 4 exemptions to apply to sections 12(1) and 12(2) alike, Congress simply could have begun section 4 by stating "The provisions of sections 5 and 12 shall not apply to. . . . " The courts have consistently held that the section 4 exemptions do not apply to section 12(2). Wright v. National Warranty Co., L.P., 953 F.2d 256, 262 (6th Cir.1992) (the securities were exempt from registration requirements pursuant to section 4(2), yet the case was remanded based on section

---

[13] In the context of Regulation D limited offerings, the Commission, in exempting certain transactions from the scope of the registration requirements of section 5, has stated that "Such transactions are not exempt from the antifraud, civil liability, or other provisions of the federal securities laws." 17 C.F.R. § 230.501 et seq. (Preliminary notes). Thus, the Commission interprets section 5 as not limiting section 12(2).

12(2)); Haralson v. E.F. Hutton Group, Inc., 919 F.2d 1014, 1032 (5th Cir.1991); Nor-Tex Agencies, Inc. v. Jones, 482 F.2d 1093, 1099 (5th Cir.1973), cert. denied, 415 U.S. 977, 94 S.Ct. 1563, 39 L.Ed.2d 873 (1974); Hill York Corp. v. American Int'l Franchises, Inc., 448 F.2d 680, 695 (5th Cir.1971); Woodward v. Wright, 266 F.2d 108, 116 (10th Cir.1959); see Landreth Timber Co. v. Landreth, 471 U.S. 681, 694-95 n. 7, 105 S.Ct. 2297, 2307 n. 7, 85 L.Ed.2d 692 (1985). To apply the exemptions of sections 3 and 4 to section 12(2) would also collapse any distinction between sections 3 and 4. In Landreth, the Supreme Court rejected the sale of business doctrine. The petitioner had sought rescission of stock pursuant to section 12(1) of the 1933 Act (for failure to register the securities) and fraud damages pursuant to the 1934 Act. Id., 471 U.S. at 684, 105 S.Ct. at 2300-01. Although the case did not involve prospectus fraud under section 12(2), the Court stated

> The 1934 Act contains several provisions specifically governing tender offers, disclosure of transactions by corporate officers and principal stockholders, and the recovery of short-swing profits gained by such persons. Eliminating from the definition of "security" instruments involved in transactions where control passed to the purchaser would contravene the purposes of these provisions. Furthermore, although § 4(2) of the 1933 Act exempts transactions not involving any public offering from the Act's registration provisions, there is no comparable exemption from the antifraud provisions.

Id. at 692, 105 S.Ct. at 2305 (emphasis added; citations omitted). Finally, a statute that states when a registration statement is required does not necessarily dictate when a

prospectus materializes.[14] See, e.g., Capri v. Murphy, 856 F.2d 473, 476 (2d Cir.1988).

For example, suppose section 5 stated that unless the state issued a person a firearms license, a person could not carry a handgun; and section 12(2) made it unlawful to kill another person while using a handgun. Certainly a person (whether or not he had a firearms license) would violate section 12(2) by using a handgun to kill another person, even though section 5 contemplates a person using a handgun only after first being issued a firearms license. The analysis does not aid in defining what constitutes a handgun. In the same manner, although section 5 contemplates a registration statement prior to a prospectus, an examination of section 5 does not assist in defining the term prospectus in section 12(2). Therefore, nothing in section 12(1) requires a different definition of prospectus in section 12(2) than that contained in section 2(10).

Section 12(2) forbids fraud "by means of a prospectus or oral communication." Pacific argues that the addition of the words "oral communication" broadens the definition of prospectus, although they clearly are neither arguing that the stock purchase agreement is an oral communication nor that other oral communications are at issue in this case. The 1933 Act does not define "oral communication." We agree with the Third Circuit that the term "oral communication" is restricted to those oral communications relating to a prospectus. Ballay, 925 F.2d

---

[14] Note that even where a registration statement is not required, sellers are free to voluntarily register their securities. Section 6 ("Any security may be registered").

at 688, citing Schreiber v. Burlington Northern Inc., 472 U.S. 1, 8, 105 S.Ct. 2458, 2462, 86 L.Ed.2d 1 (1985) ("words grouped in a list should be given related meaning" (citation omitted)).

> This reading comports with the canon of construction noscitur a sociis, which instructs that a provision should not be viewed "in isolation but in the light of the words that accompany it and give [it] meaning." Massachusetts v. Morash, 490 U.S. 107, 115, 109 S.Ct. 1668, 1673, 104 L.Ed.2d 98 (1989). As the Supreme Court noted when construing the meaning of one term in a phrase:
>
> [t]he maxim noscitur a sociis, that a word is known by the company it keeps, while not an inescapable rule, is often wisely applied where a word is capable of many meanings in order to avoid the giving of unintended breadth to the Acts of Congress. Jarecki v. G.D. Searle & Co., 367 U.S. 303, 307, 81 S.Ct. 1579, 1582, 6 L.Ed.2d 859 (1961).

Ballay, 925 F.2d at 688. The words "oral communication" are words of form, not substance; they describe how one communicates a message, not the message content. Whether the term prospectus in section 2(10) is found to include a certain message, certainly Congress intended the same words, though spoken orally, to enjoy exactly the same treatment. A prospectus in section 2(10) includes a "prospectus, notice, circular, advertisement, letter, or communication, written or by radio or television." By adding "or oral communication" in section 12(2), Congress was just adding oral communications to the section 2(10) list. The key to defining prospectus,

however, is not in the listed communication media, but rather in whether the substance of the words used offers to sell or confirm the sale of a security.

In this case the parties dispute the definitional scope of prospectus in section 12(2). Allen argues to confine a prospectus to initial offerings; Pacific wants the broad definition in section 2(10) to apply. Section 2(10) is broad enough to include initial and secondary market transactions. But section 2 begins with the phrase "When used in this title, unless the context otherwise requires. . . ." Although the 1933 Act may contain more than one definition of a prospectus, considering the foregoing analysis, we cannot say that the structure of the 1933 Act, the text of section 12, and in particular the context of the word "prospectus" in section 12(2), require a definition of prospectus contrary to the broad definition of section 2(10). The text of the 1933 Act refutes Allen's contention that section 12(2) applies only to initial offerings. Allen nevertheless argues that the legislative history shows Congress' intention to limit the scope of civil liability under the 1933 Act.[15]

---

[15] In the context of an initial offering memorandum, the Supreme Court has held that section 28(a) of the Securities and Exchange Act of 1934 (1934 Act) does not require a rescissionary recovery under section 12(2) of the Securities Act or section 10(b) of the Exchange Act to be offset by any tax benefits received from a tax shelter investment. Randall v. Loftsgaarden, 478 U.S. 647, 667, 106 S.Ct. 3143, 3155, 92 L.Ed.2d 525 (1986). In looking to the rescissionary wording of section 12(2), the Court cited the usual phrase that "the starting point in construing a statute is the statute itself" and concluded that section 12(2) "speaks with the clarity necessary to invoke this 'plain meaning' canon." Id., 478 U.S. at 656, 106 S.Ct. at 3149. However, the

III. The Legislative History of the 1933 Act

In Rowland, the Court indicated that in a statute involving language conditioned upon its "context," legislative history should not affect the decisionmaking. Id., ___ U.S. at ___, 113 S.Ct. at 720. Thus, in the present case we could rest on our analysis up to this point. We will nevertheless address the legislative history, because the district court followed Ballay, which relied extensively on legislative history. While we reject Ballay's legislative history analysis, we also note that Rowland appears to reject any reliance upon legislative history for "context" purposes.

In Ballay the Third Circuit placed emphasis on the legislative history of the 1933 Act to illustrate Congress' intent that section 12(2) "regulate initial offerings." 925 F.2d at 690 (relying on the object and structure of the Act and citations to the House Report, H.R.Rep. No. 85, 73d Cong., 1st Sess. (1933)). We will begin by briefly tracing the pertinent legislative history from the House, then from the Senate and finally Congress's compromise of both versions.[16] The final House version of section 12(2)

Court has confined its interpretation of section 12 rescission to a remedy analysis; in determining "seller" status under section 12(1), the Court has stated "there is no indication that Congress employed the remedy for its delineation of potential defendants." Pinter v. Dahl, 486 U.S. 622, 647-48 n. 23, 108 S.Ct. 2063, 2079 n. 23, 100 L.Ed.2d 658 (1988). Thus, Randall does not confine our analysis to the plain meaning of section 12(2). Rather, the Court has continued to look at the legislative history in securities cases.

[16] [G]eneralized references to the remedial purposes of the securities laws will not justify reading a provision more broadly

proposed by the House Interstate and Foreign Commerce Committee stated that:

> Sec. 12. Any person who – (2) sells a security (whether or not exempted by section 3), by the use of any means of instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of material fact or omits to state a material fact (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such truth or omission, shall be liable to the person purchasing such security from him. . . .

H.R. 5480, 73d Cong., 1st Sess. (1933), as passed by the House on May 5, 1933, 3 Ellenberger & Maher, item 26, at 25. Pursuant to this version, the House Report made the following comments about the Act:

> The character of civil liabilities imposed by this bill are described in detail elsewhere. Their essential characteristic consists of a requirement that all those responsible for statements upon the face of which the public is solicited to invest

---

than its language and the statutory scheme reasonably permit. Thus, if the language of a provision of the securities laws is sufficiently clear in its context and not at odds with the legislative history, it is unnecessary to examine the additional considerations of policy that may have influenced the lawmakers in their formulation of the statute. Aaron v. SEC, 446 U.S. 680, 695, 100 S.Ct. 1945, 1955, 64 L.Ed.2d 611 (1980) (citations and quotations omitted).

> its money shall be held to standards like those imposed by law upon a fiduciary.
>
> * * *
>
> The bill affects only new offerings of securities. . . . It does not affect the ordinary redistribution of securities unless such redistribution takes on the characteristic of a new offering by reason of the control of the issuer possessed by those responsible for the offering.

H.R.Rep. No. 85, 73d Cong., 1st Sess. (1933), to accompany H.R. 5480, May 4, 1933, 2 Ellenberger & Maher, item 18, at 5 (emphasis added).

> In view of these [transaction and security] exemptions and the restriction of the bill's application to new offerings, the bill does not affect transactions beyond the need of public protection.

Id. at 7 (emphasis added).

> Section 10 of the bill requires that any "prospectus" used in connection with the sale of any securities, if it is more than a mere announcement of the name and price of the issue offered and an offer of full details upon request, must include a substantial portion of the information required in the "registration statement." The Commission is given power to classify prospectuses according to the nature and circumstances of their use and to prescribe the form and contents appropriate to each class. While a leeway is given to the Commission to meet the varying exigencies of business transactions, fundamental safeguards necessary to insure a fair disclosure are to be preserved.

> "Prospectus" is defined in section [2(10)] to include "any prospectus, notice, circular, advertisement, letter, or other communication offering any security for sale."
>
> The purpose of these sections is to secure for potential buyers the means of understanding the intricacies of the transaction into which they are invited. The full revelations required in the filed "registration statement" should not be lost in the actual selling process. This requirement will undoubtedly limit the selling arguments hitherto employed. That is its purpose. . . . Any objection that the compulsory incorporation in selling literature and sales argument of substantially all information concerning the issue, will frighten the buyer with the intricacy of the transaction, states one of the best arguments for the provision.

Id. at 8 (emphasis added).

> Sections 11 and 12 create and define the civil liabilities imposed by the act and the machinery for their enforcement which renders them practically valuable. Fundamentally, these sections entitle the buyer of securities sold upon a registration statement including an untrue statement or omissions of material fact, to sue for recovery of his purchase price, or for damages not exceeding such price, those who have participated in such distribution either knowing of such untrue statement or omission or having failed to take due care in discovering it. . . .
>
> The committee emphasizes that these [civil] liabilities attach only when there has been an untrue statement of material fact or an omission

> to state a material fact in the registration statement or the prospectus – the basic information by which the public is solicited.

Id. at 9 (emphasis added). This discussion of sections 10-12 and the definition of prospectus show that, in the main, prospectuses arise after registration statements are filed; thus the reason that the prospectus "must include a substantial portion of the information required in the 'registration statement.' " The broad definition of a prospectus in section 2(10) prevented sellers from thwarting the registration statement provisions by artfully drafting subsequent "selling literature." In discussing the exemptions to the requirement of filing a registration statement, the House Report continued:

> The provisions of this section [4] exempt certain transactions from the provisions of section 5, which section requires both the registration of securities as a condition precedent to offering them for sale . . . , and which section also requires that after the effective date of registration prospectuses relating to such securities shall conform to the requirements of the act.
>
> Paragraph (1) broadly draws the line between distribution of securities and trading in securities, indicating that the act is, in the main, concerned with the problem of distribution as distinguished from trading. It, therefore, exempts all transactions except by an issuer, underwriter, or dealer.

Id. at 15. Based on the House Report, the legislative history of the 1933 Act can be read to focus on those offerings requiring a registration statement, or as the Third Circuit interprets, to initial offerings.

The Senate, however, proceeded along a different course. The final Senate version of section 12(2) (contained in section 9 of the Senate's version) proposed by the Senate Banking and Currency Committee, see S. 875, May 8, 1933, 77 Cong.Rec. 2996-3000 (1933), 1 Ellenberger & Maher, item 8, at 2998, stated that:

> [Sec. 12]. Every person acquiring any security by reason of any false or deceptive representation made in the course of or in connection with a sale or offer for sale or distribution of such securities shall have the right to recover any and all damages suffered by reason of such acquisition of such securities from the person or persons signing, issuing, using, or causing, directly or indirectly, such false or deceptive representation, jointly or severally.

H.R. 5480, 73d Cong., 1st Sess. (1933), as passed the Senate with Senate amendments May 10, 1933, 3 Ellenberger & Maher, item 27, at 60 (emphasis added). The Senate's version of the 1933 Act allowed recovery for fraud in the sale of "any security," not just those involved in initial offerings. The Senate rarely mentioned the word "prospectus," and certainly not in the fraud context of section 12(2).[17] And the Senate, as compared with the House, did not draft as detailed a report in support of the bill. Although the Senate did not as extensively explain its version, the differing texts display a distinctive treatment on their face.

---

[17] The Supreme Court has noted that the legislative history of section 12(2) is "sparse". Randall, 478 U.S. at 657, 106 S.Ct. at 3149-50.

A conference by the House and Senate resulted in the 1933 Act as now codified in 15 U.S.C. §§ 77a et seq. After the conference by the House and Senate, the managers on the part of the House attached a commentary to the final version, addressing the distinctions and the resolution between the previous versions:

> The Senate amendment imposed liability upon persons making false and deceptive statements in connection with the distribution or sale of a security. The House bill made the liability depend upon the making of untrue statements or omissions to state material facts. This phrase has been clarified in the substitute to make the omission relate to the statements made in order that these statements shall not be misleading, rather than making a mere omission – unless the act expressly requires such a fact to be stated – a ground for liability where no circumstances exist to make the omission itself misleading.
>
> The House bill (sec. 12) imposes civil liability for using the mails or the facilities of interstate commerce to sell securities (including securities exempt, under section 3, from other provisions of the bill) by means of representations which are untrue or misleading by reason of omissions of material facts. The substantially similar provisions of the Senate amendment did not apply to any of the securities exempted under the Senate amendment. The substitute exempts from the operation of this section sales of securities covered by section 3(a)(2), which relates, broadly speaking, to securities issued or guaranteed by the United States or any State, Territory, or the District of Columbia, or by a public instrumentality, or by a Federal Reserve bank or national bank, or by a supervised State bank.

Conference Report submitted in House and agreed to, May 22, 1933, 77 Cong.Rec. 3891-3902 (1933), 1 Ellenberger & Maher, item 13, at 3902 (emphasis added); H.R.Rep. No. 152, 73d Cong., 1st Sess. (1933) (Conference Report) to accompany H.R. 54809, May 20, 1933, 2 Ellenberger & Maher, item 19, at 26 (emphasis added).[18] Allen in this case points to section 12(c) of the Senate's final version (not included in the final 1933 Act) to show that the Senate intended the civil fraud provisions to apply only to initial offerings.

> Section 12. Except as hereinafter otherwise expressly provided, the provisions of this Act shall not apply to any of the following transactions: . . . (c) Isolated transactions in which any security issued subsequent to the date of approval of this Act is sold, or offered for sale, subscription, or delivery by the owner thereof, or by his representative solely for the owner's account, such sale or offer for sale, subscription, or delivery not being made in the course of repeated and successive transactions of a like character by such owner for the purpose of engaging in the purchase and sale of securities as a business, such owner or representative not being the issuer or underwriter of, or selling agent for, such security.

H.R. 5480, 73d Cong., 1st Sess. (1933), as passed the Senate with Senate amendments on May 10, 1933, 3 Ellenberger & Maher, item 27, at 66. Taking for granted (without deciding) that the language of section 12(c) limits the

---

[18] The Senate passed the conference report (the final version of the 1933 Act) without a similar commentary on the part of the Senate managers. May 22-23, 1933, 77 Cong.Rec. 3879-3888; 4009 (1933), 1 Ellenberger & Maher, item 14, at 3888.

provisions of the Act to initial offerings, the conference report stated that the "substantially similar [civil liability] provisions of the Senate amendment did not apply to any of the securities exempted under the Senate amendment." The conference report thus interpreted section 9 of the Senate's version, which began with the phrase "Every person acquiring any security," as language that "expressly provided" that the limitations of section 12(c) would not have applied. Therefore, we reject Allen's assertion that the Senate's final version displayed any limitation of the civil liability provisions to initial offerings.

The commentary by the House's managers did not mention their version that had limited the application of section 12(2) to fraud in a prospectus or oral communication; rather, the report recognized the Senate version, which applied section 12(2) to the distribution or sale of a security. The Senate version, as the House, had defined "sale" very broadly.[19] And there is no legislative history

[19] The Senate version had defined "sale" or "sell" to include every disposition, or attempt to dispose, of a security or interest in a security for value. For the purposes of the enforcement of this Act only, any security given or delivered with, or as a bonus on account of, any purchase of securities or any other thing, shall be conclusively presumed to constitute a part of the subject of such purchase. "Sale" or "sell" shall also include a contract to sell, an exchange, an attempt to sell or exchange, an option of sale, purchase, or exchange, a solicitation of a sale or an exchange, a subscription or an offer to sell or exchange, directly or by an agent, or by a circular, letter, advertisement, or otherwise. H.R. 5480, 73d Cong., 1st Sess. (1933), section 2(c), as passed the Senate with Senate amendments on May 10, 1933, 3 Ellenberger & Maher, item 27, at 40.

in the Senate that requires the "sale" of a security be limited to initial offerings. In the face of the Senate's broad wording, that civil fraud applies to any sale, the commentary by the House's managers after the joint conference remained silent. Although the legislative history in the House report can be read to focus solely on those offerings pursuant to a registration statement and prospectuses (or in the Third Circuit's words, to initial offerings), the Senate's version of the 1933 Act and the conference report do not confirm the House's comments. Thus, our reading of section 12(2) is not at odds with the legislative history. The legislative history of the 1933 Act does not require the context of the word "prospectus" to have a more narrow definition than that specified in section 2(10).

IV. The impact of Section 12(2) on the 1933 Act Section 17 and the 1934 Act Section 10(b)

The defendants argue that section 12(2) should be viewed in light of corresponding provisions in the 1933 Act and the Securities Exchange Act of 1934 (1934 Act), 48 Stat. 891, 15 U.S.C. §§ 78a et seq.[20] Specifically, "the interdependence of the various sections of the securities laws is certainly a relevant factor in any interpretation of the language Congress has chosen." SEC v. National Sec., Inc., 393 U.S. 453, 466, 89 S.Ct. 564, 571, 21 L.Ed.2d 668 (1969), quoted in Hochfelder, 425 U.S. 185, 206, 96 S.Ct.

[20] As with the 1933 Act, the citations in the opinion will refer to the more familiar sections of the 1934 Act, rather than to the particular sections of the United States Code.

1375, 1387, 47 L.Ed.2d 668.[21] See Pinter, 486 U.S. at 651, 108 S.Ct. at 2080-81 (criticizing an analysis that is divorced from "any reference to the applicable statutory language and from any examination of § 12 in the context of the total statutory scheme."). Accord Rowland, ___ U.S. at ___, 113 S.Ct. at 720. Allen points to the differences between sections 12(2) and 17 of the 1933 Act: Section 12(2) allows a purchaser to obtain rescission in a case involving a "prospectus or oral communication" that contains a false, material fact. Section 17(a) of the 1933 Act, however, makes it unlawful for "any person in the offer or sale of any securities . . . directly or indirectly"

> (1) to employ any device, scheme, or artifice to defraud, or
>
> (2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

---

[21] With regards to the 1934 Act section 10(b) claims, the Supreme Court recently adopted the one and three year statutes of limitations of section 9(e), rather than apply state borrowing principles. Lampf, Pleva, Lipkind v. Gilbertson, ___ U.S. ___, ___, and n. 9, 111 S.Ct. 2773, 2782 and n. 9, 115 L.Ed.2d 321 (1991). The Court noted the effect such an interpretation would have on the "complex web of regulations"; in particular, sections 9, 18 and 20A of the 1934 Act, and section 13 of the 1933 Act. Id., ___ U.S. at ___-___, 111 S.Ct. at 2780-82.

In United States v. Naftalin, 441 U.S. 768, 778-79, 99 S.Ct. 2077, 2084, 60 L.Ed.2d 624 (1979), section 17(a) was the basis of Naftalin's criminal conviction for selling his broker short. He argued successfully to the Eighth Circuit that section 17(a) forbids such fraud only against investors, not brokers. 579 F.2d 444, 447 (1978). The Supreme Court reversed, holding that section 17(a) applied to the entire selling process. 441 U.S. at 772-73, 99 S.Ct. at 2083-84.

Allen notes correctly that section 17 applies to securities sold "directly or indirectly," while section 12(2) applies to a "prospectus or oral communication." Allen argues, by negative implication, that because Congress had intended the scope of section 17 to include initial and secondary sales, by not using the identical words "directly or indirectly" in both sections, Congress intended to confine section 12(2) to initial offerings. Compare Ballay, 925 F.2d at 691 with Barnes v. Osofsky, 373 F.2d 269, 272 (2d Cir.1967) ("In contrast both §§ 12(2) and 17, the antifraud sections of the 1933 Act . . . are not limited to the newly registered securities."). The short rejection of Allen's argument is that Congress, within certain constitutional bounds, can write the statute as Congress desires. In addition, nothing in the Supreme Court's reasoning in Naftalin directs that a broad reading of section 17 dictates a narrow reading of the remainder of the 1933 Act.

Naftalin is first and foremost a teaching in statutory construction. The Supreme Court interpreted the words "offer" and "sale" and concluded that the Congress intended a broad interpretation. 441 U.S. at 773, 99 S.Ct. at 2081-82. "Prospectus" is likewise explicitly defined in

section 2 of the 1933 Act, yet Allen now wishes a narrow interpretation of the word. The Supreme Court also interpreted the language of section 17, "Any person in the offer or sale of any securities . . . directly or indirectly . . . to employ any device, scheme, or artifice to defraud . . . ," as not requiring that "the victim of the fraud be an investor." Id. Likewise, as this opinion discusses above in part II.A, nothing in sections 2(10) or 12(2) requires a distinction between initial offerings and secondary trading.

Next, Naftalin argued that the primary purpose of the 1933 Act was to protect investors, not brokers (resting upon language in the Hochfelder opinion, 425 U.S. 185, 195, 96 S.Ct. 1375, 1382, 47 L.Ed.2d 668). Naftalin, 441 U.S. at 775, 99 S.Ct. at 2082-83. The Supreme Court rejected the argument, concluding that investor protection was not the sole purpose of the 1933 Act; Congress also wanted to encourage a high ethical standard in "every facet of the securities industry." Id., 441 U.S. at 775, 99 S.Ct. at 2082-83, citing SEC v. Capital Gains Bureau, 375 U.S. 180, 186-187, 84 S.Ct. 275, 280, 11 L.Ed.2d 237. The Supreme Court found ample support for this conclusion in the legislative history of section 17(a). In this case, the parties do not dispute that section 12(2) protects purchasers.

Lastly, Naftalin argued that the 1933 Act concerned only initial public offerings and that because his fraud occurred in the aftermarket, only the 1934 Act applied. Naftalin, 441 U.S. at 778, 99 S.Ct. at 2084. The Supreme Court had described the 1933 Act as "designed to provide investors with full disclosure of material information concerning public offerings of securities in commerce, to

protect investors against fraud and, through the imposition of specified civil liabilities, to promote ethical standards of honesty and fair dealing." Hochfelder, 425 U.S. at 195, 96 S.Ct. at 1382. In Naftalin the Supreme Court added that "the 1933 Act was primarily concerned with the regulation of new offerings." Naftalin, 441 U.S. at 777-78, 99 S.Ct. at 2083-84. In the context of section 17(a) of the 1933 Act, however, the Supreme Court carved out an exception to these general statements, concluding that section 17(a) "was meant as a major departure from that limitation. Unlike much of the rest of the [Securities] [A]ct, it was intended to cover any fraudulent scheme in an offer or sale of securities, whether in the course of an initial distribution or in the course of ordinary market trading." Id., 441 U.S. at 778, 99 S.Ct. at 2084.

Allen argues that section 12(2) is not another "major departure" from the general observation that the 1933 Act applies only to initial offerings and the 1934 Act applies to secondary market transactions. We do not share in Allen's enthusiasm. Yes, the Supreme Court assumed that much of the 1933 Act regulates new offerings. In this case Pacific does not challenge that precept. But the Supreme Court viewed section 17 as a major departure from the 1933 Act in the sense that the criminal fraud provision "covered any fraudulent scheme." Naftalin, 441 U.S. at 778, 99 S.Ct. at 2084.[22] Section 12(2) is not that major a

---

[22] "This is made abundantly clear both by the statutory language, which makes no distinctions between the two kinds of transactions, and by the [legislative history]." Naftalin, 441 U.S. at 778, 99 S.Ct. at 2084. As this opinion discusses in part II.B, Congress intended the 1933 Act's civil fraud provisions to apply to initial offerings and to secondary trading.

departure – the civil fraud provision does not apply to any fraudulent scheme, only to a particular circumstance of fraud in a prospectus. Such particular articulation by Congress sets section 12(2) apart from any analysis based on general observations. Hochfelder, 425 U.S. at 200 and 207-08, 96 S.Ct. at 1384 and 1387-88.

In addition to sections 12(2) and 17 of the 1933 Act, another corollary civil fraud provision appears in the 1934 Act. In fact, the scope of section 10(b) of the 1934 Act seems to have caused the relatively recent emphasis in section 12(2). In Hochfelder, the Supreme Court was presented with the scope of section 10(b) and the Securities and Exchange Commission rule 10b-5, 17 C.F.R. § 240.10b-5 (1975 (first promulgated in 1942)). They make it unlawful for any person to use any manipulative or deceptive device in the purchase or sale of any security, and provide plaintiffs with a civil damage provision under which to seek redress for material misstatements or omissions of fact.[23] The circuit courts of appeals were split on the necessary showing regarding the misstatement; the standard had ranged from simple negligence to intentional fraud. The Supreme Court chose a standard close to the latter, holding that a private right of action under section 10(b) and rule 10b-5 must show "scienter"; that is, an intent to deceive, manipulate or defraud. Hochfelder, 425 U.S. at 188, 96 S.Ct. at 1378. Because of

---

[23] Section 10(b) and rule 10b-5 do not expressly provide a civil remedy for a violation. An implied private action was first permitted in Kardon v. National Gypsum Co., 69 F.Supp. 512 (E.D.Pa.1946). By 1976 the Supreme Court had simply assumed the existence of such a right developed by a substantial body of case law. Hochfelder, 425 U.S. at 196-97, 96 S.Ct. at 1382-83.

the scienter requirement defrauded persons would have to look to other federal or state security act provisions to challenge a negligent misstatement or omission of fact.

One of the many reasons the Supreme Court restricted the scope of section 10(b) and rule 10b-5 was the express civil fraud remedies available in the 1933 Act and their corresponding procedural limitations. Id. For example, an action under sections 11 and 12 of the 1933 Act explicitly recite different negligence standards, are limited by a three year statute of limitations period and require the plaintiff to post a bond for costs and attorney fees. Section 10(b) of the 1934 Act or rule 10b-5 promulgated thereunder have no comparable restrictions. The Supreme Court reasoned that to have expanded section 10(b) and rule 10b-5 would have effectively negated many other, more explicit, sections of the 1933 Act. Of course, by closing the door under section 10(b) and rule 10b-5 to persons who have been negligently defrauded, but who cannot prove scienter, the Supreme Court invited all such persons to look to other sections of the securities law. Against this backdrop purchasers alleging fraud, including Pacific in this case, are seeking relief under section 12(2) of the 1933 Act. Nothing in the Supreme Court's decision in Naftalin or Hochfelder, or section 17 of the 1933 Act or section 10(b) of the 1934 Act requires a different interpretation of section 12(2).

Lastly, Allen argues that section 12(2) should be confined to initial offerings for various policy reasons, the majority of which merely rephrase their substantive arguments already discussed. In light of the textual clarity of section 12(2) and the corresponding legislative history, we need not comment further. Pinter, 486 U.S. at 653, 108

S.Ct. at 2081-82; cf. Landreth, 471 U.S. at 694-95 n. 7, 105 S.Ct. at 2307 n. 7.

V. Conclusion

Contrary to the Third Circuit, we hold that section 12(2) applies to initial offerings and secondary market transactions. This comports with the Supreme Court's understanding in Wilko and what the First and Tenth Circuits have already permitted. See supra, part I. Nothing in the structure of the 1933 Act, the context of section 12 or in the legislative history otherwise requires a definition of prospectus different from that stated in section 2(10). Neither section 17 of the 1933 Act nor section 10(b) of the 1934 Act require the contrary. For these reasons, section 12(2) applies to any communication which offers any security for sale or confirms the sale of any security, including the stock purchase agreement in the present case. The order of the district court is REVERSED, and the case is REMANDED for proceedings consistent with the foregoing opinion.

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

ALLOYD COMPANY, INC., et al.	)	
Plaintiffs,	)	
vs.	)	No. 91 C 889
ARTHUR L. GUSTAFSON, et al.	)	
Defendants.	)	

To: The Honorable Ann C. Williams United States District Judge

REPORT AND RECOMMENDATION

Joan H. Lefkow, Executive Magistrate Judge:

This suit arises out of a Stock Purchase Agreement ("Agreement") pursuant to which plaintiffs, Alloyd Company, Inc. ("New Alloyd"), formerly known as Alloyd Holdings, Inc. ("Holdings"), and Wind Point Partners II ("Wind Point"), agreed to purchase the majority of the stock of Alloyd, Inc. ("Old Alloyd") from defendants Arthur Gustafson, Daniel McLean and Francis Butler. The First Amended Complaint ("complaint"), alleges in count I that defendants made material misrepresentations in connection with the sale of their stock in violation of section 12(2) of the Securities Act of 1933 ("the 1933 Act"), 15 U.S.C. § 771(2), and in count II that defendants breached certain warranty provisions contained in the Agreement.

For the second time,[1] defendants seek summary judgment on all counts of the complaint. The plaintiffs have also renewed their cross motion for summary judgment with respect to liability on the breach of warranty claim (count II).

* * *

ANALYSIS

1. Defendants' Motion Regarding Plaintiffs' Section 12(2) Claim

Defendants raise several arguments in support of their motion for summary judgment with respect to Count I of the Complaint. They argue that despite the Seventh Circuit's recent holding in *Pacific Dunlop Holdings, Inc. v. Allen & Co., Inc.*, 993 F.2d 578 (7th Cir. 1993), section 12(2)[6] does not apply to the type of secondary

[1] The parties previously filed cross motions for summary judgment. On May 29, 1992, Your Honor granted defendants' motion for summary judgment and denied plaintiffs' motion as moot. *Alloyd v. Gustafson*, No. 91 C 889, Mem. Opinion and Order (N.D. Ill. May 29, 1992). On appeal, the Seventh Circuit entered an order remanding the case for reconsideration in light of *Pacific Dunlop Holdings, Inc. v. Allen & Co., Inc.*, 993 F.2d 578 (7th Cir. 1993).

[6] Section 12(2) provides:

> Any person who –
>
> (2) offers or sells a security . . . , by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission, shall be liable to the person purchasing such security from him. . . .

market transaction at issue in this case. Additionally, they assert that the plaintiffs have waived their right to any remedy under section 12(2). Finally, with respect to the merits of the section 12(2) claim, defendants contend that plaintiffs have failed to offer any proof of a misrepresentation of material fact and that even if they had, defendants did not know of and could not reasonably have discovered the misrepresentation. Plaintiffs respond that the Seventh Circuit's decision in *Pacific Dunlop* applies section 12(2) to secondary market transactions, like the one at issue, as well as initial offerings. They also assert that they did not waive their rights under section 12(2) and that the record contains evidence supporting each of the elements of their *prima facie* case under section 12(2).

Your Honor, in a May, 1992 opinion regarding the parties' previous cross motions for summary judgment, considered whether the plaintiffs' section 12(2) claim should be dismissed because that section can only be applied to initial offerings. *See Alloyd v. Gustafson*, No. 91 C 889, Mem. Opinion and Order at 10-12 (N.D. Ill. May 29, 1992) ("May, 1992 Opinion"). Noting a division in the case law, the court found the Third Circuit's decision in *Ballay v. Legg Mason Wood Walker, Inc.*, 925 F.2d 682 (3d

Cir. 1991), persuasive. In *Ballay*, the Third Circuit determined that the language and legislative history of section 12(2), as well as its context within the schemes of the 1933 Act and the Securities Exchange Act of 1934 ("the 1934 Act"), established that section 12(2) was only intended to apply to initial offerings of securities and not to secondary transactions. *Id.* at 693. *See Pacific Dunlop*, 1991 U.S. Dist. LEXIS 6748 (N.D. Ill. May 15, 1991). At the time of that opinion, the only court in this district to have considered the issue had followed the reasoning of the *Ballay* court. As Your Honor found, this case involves a secondary market transaction and there is no evidence that it in any way resembled an initial offering.[7] Accordingly, Your Honor granted defendants' motion for summary judgment with respect to plaintiffs' section 12(2) claim and dismissed the remaining count for lack of federal jurisdiction. May, 1992 Opinion at 13.

While this case was on appeal from Your Honor's ruling, the Seventh Circuit reversed Judge Zagel's decision in *Pacific Dunlop*. Our court of appeals expressly rejected the Third Circuit's reasoning and legislative analysis in *Ballay*. Instead, the Seventh Circuit held that section 12(2) includes secondary market transactions. *Pacific Dunlop*, 993 F.2d at 582. After reviewing the case law and performing its own analysis of the provision's legislative

---

[7] Your Honor's May, 1992 Opinion noted that the legislative history of the 1933 Act suggested that section 12(2) could apply to a redistribution of securities if " 'such redistribution takes on the characteristics of a new offering by reason of the control of the issuer possessed by those responsible for the offering.' ". May, 1992 Opinion at 11-12, *citing*, H.R. No. 85, 73rd Cong., 1st Sess. 7 (1933), and *Ballay*, 925 F.2d at 690.

history, the court explained that section 12(2) applies to "any communication which offers any security for sale or confirms the sale of any security." *Id.* at 595. Subsequently, in this case, the Seventh Circuit vacated Your Honor's grant of summary judgment in favor of defendants and remanded the case for further consideration in light of *Pacific Dunlop*.

Defendants' attempt to distinguish *Pacific Dunlop* from the instant action is unconvincing. They argue that the underlying transaction in *Pacific Dunlop*, unlike the one herein, resembled an initial offering in that the sale occurred shortly after an initial offering and the buyers "apparently" did not have access to the company's books and records.[8] Although the company in *Pacific Dunlop* filed a registration statement for an initial public offering of a certain number of shares of common stock, that offering was abandoned when Pacific Dunlop entered into an agreement to purchase 92% of the company's already outstanding stock. There is no indication in the opinion as to when the stock which Pacific Dunlop purchased was actually issued. Moreover, the decision does not establish whether Pacific Dunlop had direct access to the financial records of the company to be purchased. Thus, defendant's grounds for distinguishing *Pacific Dunlop* are premised on unknown facts which should not be presumed to exist. In any event, the Seventh Circuit's

---

[8] Your Honor previously found that similar factors (passage of time between the transaction and the original issuance of stock, and buyers' access to company's financial records) strongly suggested that transaction was not comparable to an initial offering. May, 1992 Opinion at 12.

holding does not turn on whether the underlying transaction resembled an initial public offering or not. The holding is broadly worded and states that section 12(2) applies to both initial offerings of securities and secondary market transactions. Until our court of appeals or the Supreme Court indicates to the contrary,[9] section 12(2) should be applied to the Agreement at issue herein.

* * *

RECOMMENDATION

For the reasons stated, it is hereby recommended that both plaintiffs' and defendants' motions for summary judgment be denied.

Written objection to any finding of fact, conclusion of law, or the recommendation for disposition of this matter must be filed with the Honorable Ann C. Williams within ten days after service of this Report and Recommendation. *See* Fed. R. Civ. P. 72(b). Failure to object will waive any such issue on appeal.

Respectfully submitted,

/s/ Joan H. Lefkow
JOAN HUMPHREY LEFKOW
United States Magistrate Judge

Dated: March 24, 1994

---

[9] On March 14, 1994, the Supreme Court granted the defendants' petition for a writ of certiorari regarding the Seventh Circuit's order which vacated Your Honor's entry of summary judgment in their favor. Your Honor previously declined to stay the district court proceedings, including consideration of the parties' renewed motions for summary judgment, while the defendants petitioned for the writ.

STOCK PURCHASE AGREEMENT

THIS STOCK PURCHASE AGREEMENT (the "Agreement") is made and entered into as of December 20, 1989 between Alloyd Holdings, Inc., a Delaware corporation ("Buyer"), and each of Arthur L. Gustafson ("Gustafson"), Daniel R. McLean ("McLean") and Francis I. Butler ("Butler"). Gustafson, McLean and Butler are sometimes referred to herein individually, a "Seller" and collectively, the "Sellers".

RECITALS

As of the date herein, the Sellers own all of the issued and outstanding capital stock of the Alloyd Co., Inc., an Illinois corporation (the "Company"), which stock consists of 98 shares of common stock, without par value (the "Common Stock"). Subject to the terms and conditions set forth in this Agreement, at the Closing (as defined in Section 1D hereof), Buyer desires to acquire from each Seller and each Seller desires to sell to Buyer, the number of shares of Common Stock set forth next to such Seller's name on the signature pages hereto (collectively, the "Purchased Shares").

NOW, THEREFORE, the parties hereto agree as follows:

ARTICLE I

PURCHASE AND SALE OF STOCK

1A. *Stock Purchase.* On and subject to the terms and conditions set forth in this Agreement, at the Closing,

Buyer will purchase from the Sellers and the Sellers will sell, convey and transfer to Buyer all of the Purchased Shares, free and clear of all liens, charges, security interests, options, proxies, voting trusts and agreements and other encumbrances and restrictions.

1B. *Definition of Purchase Price and Estimated Purchase Price: Payments at Closing*

(a) *Purchase Price: Estimated Purchase Price.* The aggregate purchase price (the "Purchase Price") for the Purchased Shares shall be the sum of $18,709,000 *plus* the Adjustment Amount (as defined in Section 1C(a) hereof). The estimated purchase price to be delivered by Buyer to the Sellers pursuant to Section 1B(b) below (the "Estimated Purchase Price") shall be the sum of $18,709,000 *plus* 90% of the Estimated Adjustment Amount (as defined below). Prior to the Closing Date (as defined in Section 1D hereof), the Sellers Spokesperson (as defined in Section 1E hereof) shall prepare and deliver to Buyer (i) a detailed *estimated* consolidated balance sheet for the Company as of December 31, 1989, prepared as if the Closing had occurred as of the close of business on December 31, 1989 (the "Sellers' December Balance Sheet"), and (ii) Sellers' estimate of the Adjustment Amount derived therefrom (the "Estimated Adjustment Amount"). Each of the Sellers' December Balance Sheet and Sellers' calculation of the Estimated Adjustment Amount shall be accompanied by a certificate as to their accuracy and completeness in the form set forth on *Exhibit 1B(a)* hereto.

(b) *Payment of Estimated Purchase Price.* Buyer shall pay to the Sellers at the Closing the Estimated Purchase Price by delivery of:

(i) the aggregate amount of $11,709,000 to the Sellers, in accordance with the individual amounts set forth on the *Consideration Schedule* attached hereto, by wire transfer of immediately available funds to an account or accounts designated by the Sellers to Buyer prior to Closing (collectively, the "Closing Accounts");

(ii) subordinated promissory notes in the aggregate principal amount of $3,000,000 in the form of *Exhibit 1B(b).1 hereto (the "Notes") to the Sellers in the individual principal amounts set forth on the Consideration Schedule;*

(iii) the aggregate amount of $4,000,000 (the "Escrow Fund"), to be contributed by Buyer on behalf of the Sellers in accordance with the individual amounts set forth on the *Consideration Schedule,* to an escrow account established pursuant to an Escrow Agreement among Buyer, Sellers and the LaSalle National Bank, as Escrow Agent, substantially in the form of *Exhibit 1B(b).2* hereto (the "Escrow Agreement"); and

(iv) each Seller's Allocation Percentage (as set forth on the *Consideration Schedule*) of the Estimated Adjustment Amount, by wire transfer of immediately available funds to the Closing Accounts.

1C. *The Adjustment Amount.*

(a) The "Adjustment Amount" means the product of (i) the amount by which Net Book Value (as defined below) as of December 31, 1989 is greater than or less than $7,503,000, as the case may be, and (ii) a fraction, the

numerator of which is the number of days from December 31, 1988 up to and including the Closing Date and the denominator of which is 365. "Net Book Value" means the excess of the Company's Total Assets over the Company's Total Liabilities. "Total Assets" and "Total Liabilities" shall be determined as follows from the Company's audited consolidated balance sheet as of December 31, 1989 (the "1989 Balance Sheet") prepared in accordance with generally accepted accounting principles applied in a manner consistent with those used in preparing the Company's audited consolidated balance sheet as of December 31, 1988 (the "1988 Balance Sheet"). If any item on (or which should be reflected on) the 1988 Balance Sheet is not reflected in accordance with generally accepted accounting principles in effect as of December 31, 1989 (based on authoritative accounting pronouncements and literature), such item will be reflected in computing Net Book Value in accordance with generally accepted accounting principles in effect as of December 31, 1989. In computing Net Book Value for purposes of this Section 1C, the 1989 Balance Sheet (i) shall take into account all accounting entries (including all liabilities and accruals) regardless of their amount and (ii) shall reflect all adjustments and the correction of all errors and omissions; *provided*, that such entries, corrections and adjustments in (i) and (ii) above shall only be taken into account and to the extent that the aggregate net amount of all such entries, corrections and adjustments exceed $25,000, and (iii) shall, subject to the accruals required by Sections 2A(j) and 2A(q) below, be adjusted to exclude and not take into account the effect of the transactions contemplated hereby which result in the determination of

net income after corporate income taxes on a basis which is inconsistent with the determination of such net income for the year ended December 31, 1988, including without limitation, the purchase of Common Stock by the Buyer, the merger of the Company with and into the Buyer, purchase accounting adjustments, changes in accounting method and the expenses related to such transactions, including, but not limited to, bonus payments contemplated by Section 2A(h) hereof.

(b) Buyer shall deliver to the Sellers' Spokesperson no later than March 31, 1990 (i) the 1989 Balance Sheet, and (ii) Buyer's calculation of the Adjustment Amount derived therefrom (the "Buyer Adjustment Amount"). The Buyer Adjustment Amount and the 1989 Balance Sheet delivered by Buyer pursuant to the preceding sentence shall be referred to herein as "Buyer's Determinations". The Sellers' Spokesperson shall have 30 days after the delivery of Buyer's Determinations to deliver to Buyer written notice setting forth the Sellers' Spokesperson's objections to either the 1989 Balance Sheet or the Buyer Adjustment Amount, as the case may be. If the Sellers' Spokesperson sends such written objections to Buyer, any disputes between Buyer and the Sellers' Spokesperson shall be resolved in the manner described in Section 1C(c) below. In the event that the Sellers' Spokesperson fails to object to Buyer's calculation of the Adjustment Amount within the required 30 day period set forth above, the Adjustment Amount shall be equal to the Buyer Adjustment Amount.

(c) Within 30 days after delivery to the Sellers' Spokesperson of the Buyer's Determinations, the Sellers' Spokesperson shall give written notice to Buyer setting

forth in reasonable detail the basis for any such dispute or controversy. Buyer and the Sellers' Spokesperson shall promptly commence good faith negotiations with a view to resolving such dispute or controversy, provided that, if such dispute or controversy shall not be resolved within 10 days after the date of the Sellers' Spokesperson's notice, then Buyer and the Sellers' Spokesperson shall select a mutually acceptable accounting firm of national reputation (the "Neutral Accountants") to resolve such dispute or controversy. If the parties are unable to agree on an accounting firm, then each party shall select one independent accounting firm of national reputation, the two independent accounting firms so selected shall select a third independent accounting firm, and the matter shall be resolved by the third accounting firm so selected. In the event that either party fails to select an independent accounting firm as set forth herein, then the matter shall be resolved by the accounting firm selected by the other party. (If the parties are unable to agree on a mutually acceptable accounting firm and such firm is therefore selected as provided above, such firm shall be the "Neutral Accountants" for purposes hereof.) The Neutral Accountants shall make their determination as to such dispute or controversy within 45 days of their appointment. The Neutral Accountants shall act as experts, not arbitrators, and their determination shall be final, conclusive and binding as between Buyer and Sellers, absent fraud or manifest error. Buyer and the Sellers shall share responsibility for the fees and expenses of the Neutral Accountants in proportion to the degree that the Neutral Accountants have accepted the position of the other party (or parties) in interest. The audited consolidated balance

sheet of the Company as of December 31, 1989 with respect to which the Adjusted Amount is finally determined pursuant to this Section 1C, shall be referred to herein as the "Final Balance Sheet".

(d) If the Adjustment Amount as determined pursuant to Section 1C(b) or 1C(c) above is less than 90% of the Estimated Adjustment Amount (an "Overpayment"), then each Seller shall, within three business days of such determination, pay such Seller's Allocation Percentage (as set forth on the *Consideration Schedule*) of the Overpayment, together with interest on the Overpayment from the Closing Date to the date of payment at a rate of ten percent (10%) per annum (the "Interest Rate") to Buyer by certified or cashier's check.

(e) If the Adjustment Amount as determined pursuant to Section 1C(b) or 1C(c) above is greater than 90% of the Estimated Adjustment Amount (an "Underpayment"), then the Buyer shall, within three business days of such determination, pay to each Seller that Seller's Allocation Percentage (as set forth on the *Consideration Schedule*) of the Underpayment, together with interest on the such amount from the Closing Date to the date of payment at the Interest Rate, by certified or cashier's check.

1D. *Closing*. The closing of the purchase and sale of the Purchased Shares as contemplated by this Agreement (the "Closing") will take place at the offices of Kirkland & Ellis, 200 East Randolph Drive, Chicago, Illinois, at 10:00 a.m. local time on December 22, 1989 or on such other date designated by Buyer upon written notice to the

Sellers' Spokesperson (as hereinafter defined) (the "Closing Date"). Subject to the conditions set forth in this Agreement, at the Closing, (i) the Sellers will deliver to Buyer stock certificates representing the Purchased Shares, duly endorsed for transfer or accompanied by duly executed stock powers and signatures guaranteed, free and clear of all liens, charges, security interests, options, proxies, voting trusts, rights of first refusal and other encumbrances and restrictions, and (ii) Buyer will pay and deliver to the Sellers the Estimated Purchase Price in the manner described in Section 1B(b).

1E. *Sellers' Spokesperson*. The Sellers jointly and severally represent and warrant to Buyer that Buyer shall be entitled to rely exclusively, as being binding upon each of the Sellers, upon any action taken jointly by Arthur L. Gustafson and Daniel R. McLean (jointly, the "Sellers' Spokesperson") with respect to the matters contemplated by this Agreement and upon any document or other paper reasonably believed by Buyer to be genuine and to have been signed by the Sellers' Spokesperson, and Buyer shall not be liable to any such Seller for any action taken or omitted to be taken by Buyer in such reliance.

ARTICLE II

CONDITIONS TO CLOSING

2A. *Conditions to Buyer's Obligation*. The obligation of Buyer to consummate the transactions contemplated by this Agreement is subject to the satisfaction of the following conditions as of the Closing Date:

(a) The representations and warranties set forth in Article IV hereof will be true and correct in all material

respects at and as of the Closing Date as though then made and as though the Closing Date was substituted for the date of this Agreement throughout such representations and warranties (without taking into account any disclosures made by the Sellers to Buyer pursuant to Section 3A(h) hereof), except for representations and warranties expressly made as of a date subsequent to the Closing Date in which case such representations and warranties will be true and correct in all material respects as of such date only;

(b) The Sellers will have performed in all material respects all of the covenants and agreements required to be performed by them under this Agreement at or prior to the Closing Date;

(c) Since the date of the Latest Balance Sheet (as defined in Section 4D), there will have been no material adverse change in and no material adverse event affecting the business, financial condition, operating results, assets, operations or business prospects of the Company or either of the subsidiaries set forth on the *Subsidiaries Schedule* hereto (collectively, the "Subsidiaries" and individually a "Subsidiary") and there will have been no casualty losses or damage to the assets of the Company or any of the Subsidiaries which in the aggregate exceed $50,000, whether or not covered by insurance;

(d) All governmental filings, authorizations and approvals that are required for the consummation of the transactions contemplated hereby will have been duly made and obtained on terms reasonably satisfactory to Buyer;

(e) All consents by third parties that are required for the transfer of ownership of the Purchased Shares to Buyer as contemplated hereby, that are required for the consummation of the transactions contemplated hereby and that are required in order to prevent a breach of or a default under, a termination or modification of, or acceleration of the terms of, any agreement to which the Company or any of the Subsidiaries is a party or to which any of the Company's or any Subsidiary's property is subject (including real estate and equipment leases) which would adversely affect the business of the Company or either Subsidiary as presently conducted will have been obtained on terms reasonably satisfactory to Buyer and appropriate releases, including without limitation, payoff letters, mortgage releases, lien releases, receipts, termination statements, pledged securities and cancelled notes, with respect to all security interests held in the property of the Company and the Subsidiaries and in the Purchased Shares, will have been obtained on terms reasonably satisfactory to Buyer;

(f) No action or proceeding before any court or government body will be pending wherein an unfavorable judgment, decree or order would (i) prevent the carrying out of this Agreement or any of the transactions contemplated hereby, (ii) declare unlawful the transactions contemplated by this Agreement or cause such transactions to be rescinded or (iii) have a material adverse effect on the business, financial condition, operating results, assets, operations or business prospects of the Company or either Subsidiary;

(g) Neither the Federal Trade Commission nor the Department of Justice shall have outstanding any request

for information in connection with the transactions contemplated hereby under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (the "HSR Act"). No governmental agency or body shall have instituted or notified either party hereto or any of their affiliates of its intention or threat to institute any suit, action, or legal or administrative proceeding to restrain, enjoin or otherwise question the validity or legality of the transactions contemplated by this Agreement and no order or decree so restraining or enjoining such transactions shall be in effect. All waiting periods of extensions thereof provided for in Title II of the HSR Act with respect to the transactions contemplated hereby shall have expired;

(h) The Company will have entered into a Bonus Agreement with each of Daniel R. McLean and Francis I. Butler (collectively, the "Managers") in form and substance reasonably satisfactory to Buyer, and on or prior to the Closing Date the Company shall have paid to each of the Managers the bonus amounts required to be paid pursuant to such Manager's Bonus Agreement;

(i) All agreements, written or oral, among stockholders of the Company or between the Company and any stockholder or group of stockholders of the Company (including, without limitation, that certain Memorandum of Understanding dated May 5, 1989, among the Company and each of the Sellers (the "Memorandum of Understanding")) shall have been terminated by a writing in form and substance reasonably satisfactory to Buyer, in each case without any further liability or obligation on the part of the Company;

(j) On or prior to the Closing Date, (i) the Sellers shall have fully reimbursed the Company for any of the Transaction Expenses (as defined in Section 7D hereof) charged to the Company or any of the Subsidiaries or the Company shall have fully accrued for all Transaction Expenses incurred on or prior to the Closing Date, and (ii) each of the Sellers shall have fully reimbursed the Company for (x) the amount, if any, of such Seller's indebtedness to the Company (with respect to each Seller, the "Seller Debt"), and (v) the book value of any personal property distributed to such Seller by the Company pursuant to Section 2B(g);

(k) Arthur L. Gustafson shall have entered into a non-competition agreement with the Buyer in the form of *Exhibit 2A(k)* hereto (the "Non-Compete Agreement"), and as of the Closing Date the Non-Compete Agreement will be in full force and effect with respect to the Arthur L. Gustafson;

(l) At least one business day prior to Closing, each of the Managers will have entered into an Executive Stock Agreement and an Executive Employment Agreement with the Buyer in substantially the form set forth in *Exhibit 2A(1)* hereto, and as of the Closing Date such agreements (respectively, the "Executive Stock Agreements" and the "Executive Employment Agreements") shall be in full force and effect with respect to the Managers;

(m) Buyer's Lenders (as defined below) shall have provided to Buyer or its designee sufficient debt financing necessary to consummate the transactions contemplated by this Agreement on terms and conditions satisfactory to Buyer;

(n) Buyer will have received from Sellers' counsel, Vedder, Price, Kaufman & Kammholz, their opinion with respect to the matters set forth in *Exhibit 2A(n)* attached hereto, addressed to Buyer and The Prudential Insurance Company of America and the other institutions and entities providing debt financing to Buyer to consummate the transactions contemplated hereby (collectively, "Buyer's Lenders"), dated the date of the Closing and in form and substance reasonably satisfactory to Buyer and Buyer's Lenders;

(o) At the Closing, Sellers will have delivered to Buyer all of the following:

(i) A certificate signed by the Sellers in the form set forth in *Exhibit 2A(o)* attached hereto, dated the date of the Closing, stating that the preconditions specified in subsections (a) through (j) hereof, inclusive, and (q) have been satisfied;

(ii) Copies of all necessary third party and governmental consents, releases, approvals and filings required in order to effect the transactions contemplated by this Agreement;

(iii) Certificates representing the Purchased Shares, duly endorsed for transfer or accompanied by duly executed stock powers (with signatures guaranteed), together with evidence of payment of all applicable stock

transfer taxes. The Company's minute books, stock transfer records, corporate seals and other materials related to the Company's and the Subsidiaries' corporate administration and record keeping shall be at the Company's principal place of business;

(iv) Resignations, effective as of the Closing Date, from the officers and directors of the Company and each of the Subsidiaries requested by the Buyer;

(v) Good standing certificates of the Company from the State of Illinois, of each of the Subsidiaries from their respective states of incorporation, and of the Company and each of the Subsidiaries in the states where each is qualified to do business as a foreign corporation, all dated as of a date within five days prior to the Closing;

(vi) Articles of Incorporation of the Company and all amendments thereto certified, as of a date within ten business days of the Closing, by the State of Illinois and By-laws of the Company and all amendments thereto certified by its Secretary;

(vii) A Certificate of Incumbency covering all officers of the Company executing documents in connection with the transactions contemplated hereby certified by the Secretary of the Company;

(viii) A *Seller Debt Schedule* setting forth, with respect to each Seller, all amounts added to (including, without limitation, all personal expenses of each Seller charged to the Company's account) and/or subtracted to the Seller Debt of such Seller since the date of the Latest Balance Sheet;

(ix) Evidence of title insurance as follows:

(A) With respect to each parcel of real estate identified as owned by the Company or either Subsidiary on the *Owned Property Schedule*, Sellers shall have procedure an ALTA Form B - 1987 Owner's Policy of Title Insurance [or equivalent policy acceptable to the Buyer if the real property is located in a state in which an ALTA Form B - 1987 Owner's Policy of Title Insurance is not available] issued by Lawyers Title Insurance Corporation, in an amount equal to the fair market value of such real property (including all improvements located thereof, insuring title to such real property to be in Buyer of the Closing (subject only to the title exceptions set forth on the *Permitted Encumbrances Schedule*);

(B) Each title insurance policy delivered under Section 2A(o)(ix)(A) shall (i) insure title to the real property and all recorded easements benefitting such real property, (ii) contain an "extended coverage endorsement" insuring over the general exceptions contained customarily in such policies, (iii) contain an ALTA Zoning Endorsement 3.1 (or equivalent), (iv) contain an endorsement insuring that the real property described in the title insurance policy is the same real estate as shown on the survey delivered with respect to such property, (v) contain an endorsement insuring that each street adjacent to the real property is a public street and that there is direct and unencumbered pedestrian and vehicular access to such street from the real property, (vi) if the real property consists of more than one record parcel, contain a "contiguity" endorsement insuring that all of

the record parcels are contiguous to one another, and (vii) contain a "non-imputation" endorsement to the effect that title defects known to the officers, directors and stockholders of the owner prior to the Closing shall not be deemed "facts known to the insured" for purposes of the policy (if available);

(x) With respect to each parcel of real property identified as owned by the Company or either Subsidiary on the *Owned Property Schedule*, and as to which a title insurance policy is to be procured pursuant to Section 2A(o)(ix) above, Sellers shall have procedure in preparation for the Closing a current survey of the real property certified to the Buyer, prepared by a licensed surveyor and conforming to current ALTA Minimum Detail Requirements for Land Title Surveys, dated no later than thirty (30) days prior to the Closing Date, disclosing the location of all improvements, easements, party walls, sidewalks, roadway, utility lines and other matters customarily shown on such surveys and showing access affirmatively to public streets and roads (the "Survey"). Any survey defect or encroachment from or onto the real property, except for those disclosed on the *Permitted Encumbrances Schedule* attached hereto, will have been cured or insured over prior to the Closing Date;

(xi) a power of attorney, jointly executed by each of the Sellers, appointing and empowering the Sellers' Spokesperson and copies of all other documentation relating to the appointment of the Sellers' Spokesperson, all in form and substance reasonably satisfactory to Buyer; and

(xii) such other documents or instruments as Buyer reasonably requests not later than three days prior to the date of the Closing to effect the transactions contemplated hereby;

(p) The Sellers shall have entered into a Subordination Agreement with Buyer's Lenders substantially in the form of Exhibit 2A(p) attached hereto (the "Subordination Agreement") and as of the Closing Date the Subordination Agreement will be in full force and effect with respect to the Sellers; and

(q) On or prior to the Closing Date, the Company shall have paid or accrued all sales commissions and bonuses payable to the Company's and the Subsidiaries' sales employees and the Company shall have either paid or accrued the bonus amount payable to William Lord pursuant to the Memorandum of Understanding.

All proceedings to be taken by Sellers and the Company in connection with the consummation of the closing and other transactions contemplated hereby and all certificates, opinions, instruments and other documents required to effect the transactions contemplated hereby reasonably requested by Buyer will be reasonably satisfactory in form and substance to Buyer. Any condition specified in this Section 2A may be waived in writing by Buyer.

2B. *Conditions to Sellers' Obligation*. The obligation of the Sellers to consummate the transactions contemplated by this Agreement is subject to the satisfaction of the following conditions as of the Closing Date:

(a) The representations and warranties set forth in Article V hereof will be true and correct at and as of the Closing Date as though then made and as though the Closing Date was substituted for the date of this Agreement throughout such representations and warranties;

(b) Buyer will have performed all the covenants and agreements required to be performed by it under this Agreement at or prior to the Closing Date;

(c) Neither the Federal Trade Commission nor the Department of Justice shall have outstanding any request for information in connection with the transaction contemplated hereby under the HSR Act. No governmental agency or body shall have instituted or notified either party hereto or any of their affiliates of its intention or threat to institute any suit, action, or legal or administrative proceeding to restrain, enjoin or otherwise question the validity or legality of the transactions contemplated by this Agreement and no order or decree so restraining or enjoining such transactions shall be in effect. All waiting periods or extensions thereof provided for in Title II of the HSR Act with respect to the transactions contemplated hereby shall have expired;

(d) Sellers will have received from Buyer's counsel, Kirkland & Ellis, their opinion with respect to the matters set forth in *Exhibit 2B(d)* attached hereto, addressed to the Sellers, dated the date of the Closing and in form and substance reasonably satisfactory to Sellers;

(e) At the Closing Buyer will have delivered to the Sellers:

(i) a Buyer's certificate in the form set forth in *Exhibit 2B(e)* attached hereto, dated the date of the Closing, stating that the preconditions specified in subsections (a) through (c) hereof have been satisfied;

(ii) a long form good standing certificate of Buyer issued by the Secretary of State of the State of Delaware, dated as of a date within five days prior to the Closing Date;

(iii) the Certificate of Incorporation of Buyer, as of a date within 10 business days of the Closing Date, certified by the Secretary of State of the State of Delaware and Bylaws of the Buyer certified by its Secretary; and

(iv) a certificate of Incumbency covering all officers of the Buyer executing this Agreement or any of the other agreements contemplated hereby certified by Buyer's Secretary; and

(v) such other documents or instruments as Sellers reasonably request not later than three days prior to the Closing Date to effect the transactions contemplated hereby;

(f) Buyer will have paid the Estimated Purchase Price to the Sellers, will have delivered the Notes to the Sellers and will have executed the Escrow Agreement and delivered the Escrow Fund to the Escrow Agent, all as provided in Section 1B(b);

(g) The Company will have distributed to the Sellers the items of personal property set forth on the *Transferred Assets Schedule* attached hereto, and shall have paid each of the Sellers the amount, if any, by which the

sum of the book value of the personal property distributed to such Seller as provided above plus the amount of the Company's obligations to such Seller (including, without limitation, obligations for accrued salary and bonus) exceeds the amount of such Seller's Seller Debt; and

(h) The Buyer shall have executed the Non-Compete Agreement and shall have paid the consideration to Arthur Gustafson as provided therein.

All proceedings to be taken by Buyer in connection with the consummation of the Closing and the other transactions contemplated hereby and all certificates, opinions, instruments and other documents required to be delivered by Buyer to effect the transactions contemplated hereby reasonably required by the Sellers' Spokesperson will be reasonably satisfactory in form and substance to the Sellers' Spokesperson. Any condition specified in this Section 2B may be waived in writing by the Sellers' Spokesperson.

ARTICLE III

COVENANTS OF THE SELLERS PRIOR TO CLOSING AND OF BUYER PRIOR TO CLOSING

3A. *Affirmative Covenants of Seller.* Prior to the Closing Date, the Sellers will, and will cause the Company and each of the Subsidiaries to:

(a) conduct the Company's and the Subsidiaries' operations only in the usual and ordinary course of business in accordance with past practices, except as otherwise expressly contemplated by this Agreement;

(b) keep in full force and effect the Company's and the Subsidiaries' corporate existence and all rights and franchises pertaining to the Company's and Subsidiaries' business;

(c) use best efforts (consistent with sound business judgment) to retain the Company's and the Subsidiaries' employees and preserve the Company's and the Subsidiaries' present business relationships;

(d) maintain the Company's and the Subsidiaries' assets in customary repair, order and condition, ordinary wear and tear excepted, and maintain insurance comparable to that in effect as of the date of the Latest Balance Sheet (as defined in Section 4D hereof);

(e) maintain the Company's and the Subsidiaries' books, accounts and records in accordance with past custom and practice as used in the preparation of the financial statements described in Section 4D hereof (except for the regular year-end adjustments which in the aggregate are not material);

(f) permit Buyer and its employees, agents, accounting and legal representatives and potential investors and lenders (and such lenders' audit staff) and their representatives to have free and full access during normal business hours to the employees, properties, books, records, invoices, contracts, leases, key personnel, facilities and equipment of Company and each of the Subsidiaries, wherever located, in order that Buyer may have full opportunity to make such continuing investigation of the company and the Subsidiaries as it in its sole discretion shall deem necessary or desirable in connection with the transactions contemplated hereby. Without limiting the

generality of the foregoing, Seller will afford to the environmental consulting firm of Geraghty & Miller Engineers, Inc. ("Geraghty & Miller") free and full access at all reasonable times and upon reasonable notice to the officers, employees, properties, books and records of the Company and each of the Subsidiaries in order that Geraghty & Miller shall be able to conduct a comprehensive environmental due-diligence audit of the Company and the Subsidiaries;

(g) use best efforts (consistent with sound business judgment) to obtain all consents and approvals necessary or desirable to consummate the transactions contemplated hereby and to cause the other conditions to Buyer's obligation to close to be satisfied; and

(h) promptly inform Buyer in writing of any matters which become known to any Seller which would cause representations and warranties contained in Article IV hereof to be untrue in any material respect as of the date of this Agreement or as of the Closing Date.

3B. *Negative Covenants of the Sellers.* Except as otherwise specifically contemplated herein, prior to the Closing Date, without the prior written consent of Buyer, the Sellers will not, and will not permit the Company or the Subsidiaries to:

(a) make any amendments to the Company's or either Subsidiary's Articles of Incorporation or By-laws;

(b) redeem any of the Company's or either Subsidiary's capital stock, declare or pay any dividend or distribution on the Company's or either Subsidiary's capital stock or permit a withdrawal of funds or other assets

from the Company, except as otherwise expressly contemplated by this Agreement;

(c) directly or indirectly, solicit, encourage or initiate any discussion with, or negotiate or otherwise deal with or provide any information to, any Person other than Buyer and Buyer's agents and accounting and legal representatives, concerning any disposition or sale of the Purchased Shares, the Company or any of the Subsidiaries (including pursuant to sale of assets, merger or other business combination) or enter into any agreement concerning any disposition or sale of the Purchased Shares, the Company or any of the Subsidiaries (including pursuant to sale of assets, merger or other business combination), other than with respect to the transactions contemplated by this Agreement *provided* that the foregoing shall not prohibit providing information in the ordinary course of business or providing information as required by applicable law. In the event that the Sellers become legally compelled to disclose any such information, Sellers will provide Buyer with prompt notice before such disclosure so that Buyer may seek a protective order or other appropriate remedy or waive compliance with the provisions of this Agreement or both. In the event that such protective order or other remedy is not obtained, or that the Buyer waives compliance with the provisions of this Agreement, Sellers will furnish only that portion of the information which they are advised by opinion of counsel (such choice of counsel to be reasonably satisfactory to Buyer) is legally required and will exercise their best efforts to obtain a protective order or other reliable assurance that confidential treatment will be accorded the disclosed information;

(d) grant any increase in salary or otherwise increase the compensation payable to any officer, partner, employee or agent, excep' wage or salary increases as required by pre-existing contracts or compensation policies which are in the ordinary course of business consistent with past practices;

(e) enter into, amend or terminate any employment or labor agreement or any employee pension benefit plan or any employee welfare benefit plan (as described in Section 4S);

(f) terminate or modify any contract or any government license, permit or other authorization other than in the ordinary course of business;

(g) enter into any contract not in the ordinary course of business or any contract which requires aggregate payments in excess of $50,000, other than purchase orders or sale orders entered into in the ordinary course of business on the standard forms set forth on *Exhibit 4M* attached hereto;

(h) institute any material change in method of production, purchase, sale, lease, management, operation or accounting;

(i) take or omit to take any action which could be reasonably anticipated to have a materially adverse effect upon the business, financial condition, operating results, assets, operations or business prospects of the Company or either Subsidiary; or

(j) except as otherwise expressly contemplated by this Agreement, take any action that would require disclosure pursuant to Section 3A(h) hereof.

The term "Person", as used throughout this Agreement, means an individual, a partnership, a corporation, an association, a joint venture, an unincorporated organization or a governmental entity, or any department, agency or political subdivision thereof.

3C. *Affirmative Covenants of Buyer.* Prior to the Closing Date, Buyer will:

(a) Promptly inform the Sellers' Spokesperson in writing of any variances from the representations and warranties contained in Article V hereof which become known to Buyer;

(b) Use best efforts (consistent with sound business judgment) to obtain all consents and approvals necessary or desirable to consummate the transactions contemplated hereby and to cause the other conditions to the Sellers' obligations to be satisfied; and

(c) Use best efforts (consistent with sound business judgment) to obtain sufficient financing necessary to consummate the transactions contemplated by this Agreement.

ARTICLE IV

REPRESENTATIONS AND WARRANTIES OF THE SELLERS

As an inducement to Buyer to enter into this Agreement, the Sellers jointly and severally (but severally only with respect to the representations and warranties set forth in Section 4B(ii)) hereby represent and warrant to Buyer that:

4A. *Organization and Corporate Power.* The Company is a corporation duly organized, validly existing and in good standing under the laws of the State of Illinois. Each Subsidiary is a corporation duly organized, validly existing and in good standing under the respective laws of the state of its incorporation. Each of the Company and the Subsidiaries are qualified to do business as a foreign corporation in all other jurisdictions in which the character of their respective properties or the nature of their respective activities require them to do so qualified, except where the failure to be so qualified will not result in material Losses (as defined in Section 7B hereof) to the Company and the Subsidiaries taken as a whole (which Losses shall be deemed "material" for purposes of this Section 4A only in the event and then only to the extent such Losses in the agreements exceed $10,000.) Neither the Company nor the Subsidiaries are liable for any taxes or penalties resulting from the failure to qualify to do business as a foreign corporation in any jurisdiction. The Company and the Subsidiaries have all requisite power and authority and all authorizations, licenses and permits necessary to own and operate their respective properties and to carry on their respective business as now conducted. Copies of the Company's and the Subsidiaries' respective Articles or Certificate of Incorporation and By-laws have been furnished to Buyer and reflect all amendments made thereto at any time prior to the date of this Agreement and are correct and complete in all respects.

4B. *Capital Stock, etc.*

(i) The authorized capital stock of the Company consists of 500 shares of common stock, no par value per share, 98 shares of which are issued and outstanding. The

authorized capital stock of each of the Subsidiaries, the number of shares issued and outstanding thereof and the ownership thereof are all as set forth on the *Subsidiaries Schedule*. Except as set forth on the *Encumbrances Schedule* attached hereto, the Company owns all of the issued and outstanding capital stock of each Subsidiary free and clear of any security interest, claim, lien, pledge, encumbrance or charge. Except as set forth on the *Seller Encumbrances Schedule* attached hereto, none of the outstanding capital stock of the Company or either Subsidiary is subject to any agreement, voting trust, proxy or other arrangement or restriction whatsoever. All of the issued and outstanding capital stock of the Company (collectively, the "Company Stock") and each of the Subsidiaries has been duly authorized and is validly issued, fully paid and nonassessable. There are no rights, subscriptions, warrants, options, conversion rights or agreements of any kind outstanding to purchase or otherwise acquire any shares of capital stock of the Company or either Subsidiary or to acquire any securities or obligations of any kind convertible into or exchangeable for any shares of capital stock of the Company or either subsidiary. There are no agreements or other obligations (contingent or otherwise) which may require the Company or either of the Subsidiaries to repurchase or otherwise acquire any shares of their capital stock.

(ii) Except as set forth on the *Seller Encumbrances Schedule*, Arthur L. Gustafson owns beneficially and of record 83 shares of the Company Stock, Daniel R. McLean owns beneficially and of record 10 shares of the Company Stock and Francis I. Butler owns beneficially and of record five shares of the Company

Stock, and collectively the Sellers own beneficially and of record all of the issued and outstanding shares of Company Stock, in each case free and clear of any security interest, claim, lien, pledge, encumbrance or charge.

4C. *Authorization: No Breach.* This Agreement and the Escrow Agreement have been duly executed and delivered by the Sellers, and this Agreement constitutes a valid and binding obligation of the Sellers, enforceable in accordance with its terms, except as may be limited by applicable debtor relief laws and general principles of equity. Except as set forth on the *Authorizations Schedule* attached hereto, the execution, delivery and performance of this Agreement by the Sellers and the consummation of the transactions contemplated hereby do not and will not (i) conflict with or result in any breach of any of the provisions of, (ii) constitute a default under, (iii) result in a violation of, (iv) given any third party the right to terminate or to accelerate any obligation under, (v) result in the creation of any lien, security interest, charge or encumbrance upon any of the capital stock or equity interests or any assets of the Company or either Subsidiary, or (vi) require any authorization, consent, approval, exemption or other action by or notice to any court or other governmental body, under the provisions of the Articles or Certificate of Incorporation or By-laws of the Company or either Subsidiary or any indenture, mortgage, lease, loan agreement or other agreement or instrument to which the Company, either Subsidiary or the Sellers are bound or affected by any law, statute, rule or regulation to which the Company, either Subsidiary or the Sellers are subject.

4D. *Financial Statements.* Sellers have furnished Buyer with copies of (i) the 1988 Balance Sheet (including a consolidated budget for the fiscal year beginning January 1, 1989) and the Company's consolidated audited balance sheets as of December 31, 1987, December 31, 1986, December 31, 1985 and December 31, 1984 and the related audited consolidated statements of income and sources and applications of funds for the years then ended and (ii) the Company's consolidated unaudited balance sheet and related statements of income for the ten months ended October 31, 1989 (such consolidated unaudited balance sheet being referred to herein as the "Latest Balance Sheet"). The foregoing financial statements have been prepared in accordance with generally accepted accounting principles consistently applied throughout the periods indicated therein, subject, in the case of interim financials, to normal, year-end adjustments (which in the aggregate will not be material) and those adjustments set forth on the notes to the Latest Balance Sheet, which is attached hereto and shall be deemed to be the *Financial Statements Schedule* have been based upon the information contained in the Company's books and records, present fairly on a consolidated basis the Company's financial condition and related results of operations as of the times and for the periods referred to therein and, except for the Latest Balance Sheet, have been audited by a certified public accountant. The Company's books of account and financial records fairly reflect the Company's income, expenses and liabilities.

4E. *Absence of Undisclosed Liabilities.* Neither the Company nor either Subsidiary has any obligation or

liability (whether accrued, absolute, contingent, unliquidated or otherwise, whether or not known to the Sellers, the Company or either Subsidiary, whether due or to become due and regardless of when or by whom asserted) arising out of transactions entered into at or prior to the date hereof, or any action or inaction at or prior to the date hereof, or any state of facts existing at or prior to the date hereof, including taxes with respect to or based upon transactions or events occurring on or before the date hereof, except (i) obligations under contracts or commitments described on the *Contracts Schedule* attached hereto or under contracts and commitments entered into in the ordinary course of business which are not required to be disclosed thereon (but not liabilities for breaches thereof), (ii) liabilities reflected on the Latest Balance Sheet, (iii) liabilities which have arisen after the date of the Latest Balance Sheet in the ordinary course of business (none of which is a liability for breach of contract, breach of warranty, tort, infringement, claim or lawsuit) including, without limitation, accrued but unpaid taxes and accrued but unpaid annual license fees and franchise taxes and (iv) liabilities otherwise expressly disclosed in or contemplated by this Agreement or the Schedules attached hereto.

4F. *Inventories*. The inventories, net of reserves, to the extent of the values shown on the Final Balance Sheet, will consist of a quality and quantity usable and saleable in the ordinary course of business, will be merchantable and suited for the purpose for which they were manufactured and will not be damaged, defective or obsolete.

4G. *Accounts Receivable*. Except for matters of the type described in (i), (ii) and (iii) below with respect to

the accounts receivable of the Company and the Subsidiaries which in the aggregate with respect to all such matters do not and will not exceed $50,000, (i) the accounts receivable of the Company and the Subsidiaries to be reflected on the Final Balance Sheet will be valid receivables and will be collected on or before June 29, 1990 at the aggregate face amount thereof (subject to no counterclaims or offset), (ii) as of December 31, 1989, no Person or entity will have any lien on such receivables or any part thereof, and (iii) no agreements for deduction, free goods, discounts or other deferred price or quantity adjustments will have been made with respect to such receivable.

4H. *Subsidiaries*. Except for the Subsidiaries set forth on the attached *Subsidiaries Schedule*, neither the Company nor either Subsidiary owns, directly or indirectly, any stock, partnership interest, joint venture interest or other security or interest in any other corporation, organization or entity. The *Subsidiaries Schedule* fully and accurately sets forth the capitalization of each Subsidiary described therein as contemplated by Section 4A.

4I. *No Material Adverse Changes*. Since the date of the Latest Balance Sheet, there has been no material adverse change in or any material adverse event affecting the business, financial condition, operating results, assets, operations or business prospects of the Company or either of the Subsidiaries.

4J. *Absence of Certain Developments*.

(a) Except as set forth in the *Developments Schedule* attached hereto, since the date of the Latest Balance

Sheet, neither the Company nor any of the Subsidiaries have:

(i) except as otherwise expressly contemplated by this Agreement, redeemed or purchased, directly or indirectly, any shares of their capital stock or declared or paid any dividends or distributions with respect to any shares of their capital stock or permitted any other withdrawal or distribution of their funds or other assets other than for normal and reasonable salaries and the payment of their normal expenses in accordance with past practices;

(ii) issued, sold or transferred any of their equity securities, securities convertible into their equity securities or warrants, options or other rights to acquire their equity securities or partnership equity interests, or any bonds or other securities issued by them;

(iii) discharged or satisfied any lien or encumbrance or paid any liability, other than current liabilities paid in the ordinary course of business;

(iv) mortgages, pledged or subjected to any lien, charge or any other encumbrance, any of their properties or assets, except liens for current property taxes not yet due and payable;

(v) except as otherwise expressly contemplated by this Agreement, sold, assigned or transferred any of their tangible assets, except in the ordinary course of business, or cancelled without fair consideration any debts or claims owing to or held by them;

(vi) sold, assigned, transferred or otherwise encumbered any of Company's or either Subsidiary's: (A)

patents, patent applications or patent disclosures or the inventions contained therein, any reissued, continuation, continuation-in-part, division, extension, or reexamination of the foregoing (collectively, the "Patents"); (B) trademarks, service marks, trade dress, trade names or corporate names or the goodwill of the business in connection with which any such mark, name or trade dress is used (collectively, the "Trademarks"); (C) copyrights, registered or unregistered, statutory or common law, in or to any of Company's works (the "Copyrights"); (D) mask works (the "Mask Works"); (E) trade secrets and confidential business information (including ideas, formulas, compositions or inventions, whether or not patentable and whether or not reduced to practice), know-how, manufacturing and production processes and techniques, research and development information, drawings, specifications, designs, plans, proposals, technical data or customer and supplier lists (collectively, the "Confidential Information"); (F) other proprietary rights or any income, royalties, damages or payments due or payable at the Closing Date or thereafter in connection with the any of foregoing; or (G) licenses or other agreements regarding any of the foregoing (collectively, the "Proprietary Rights").

(vii) except as otherwise expressly contemplated by this Agreement, made or granted any bonus or any wage or salary increase to any employee or group of employees, or made or granted any increase in any employee benefit plan or arrangement, or amended or terminated any existing employee benefit plan or arrangement or adopted any new employee benefit plan or arrangement;

(viii) except as set forth on the *Capital Expenditures and Commitments Schedule* attached hereto, made capital expenditures or commitments therefor which in the aggregate exceed $10,000, other than commitments reflected in the Latest Balance Sheet;

(ix) except as set forth on the *Capital Expenditures and Commitments Schedule*, incurred any indebtedness for borrowed money or incurred or become subject to any liability, except current liabilities in the ordinary course of business;

(x) made any loans or advance to, or guarantees for the benefit of, any Person (other than advances to employees in the ordinary course of business);

(xi) suffered any extraordinary losses or waived any rights of material value, whether or not in the ordinary course of business or consistent with past practice;

(xii) entered into any other material transaction except as otherwise expressly contemplated by this Agreement;

(xiii) made charitable contributions or pledges which in the aggregate $10,000; or

(xiv) suffered any damage, destruction or casualty loss to their tangible assets which in the aggregate exceed $10,000, whether or not covered by insurance.

(b) No officer, director, partner, employee or agent of the Company or either Subsidiary has been or is authorized to make or receive, and Sellers do not know of the Company, either of the Subsidiaries or any of their respective officers, directors, partners, employees or

agents making or receiving, any bribe, kickback payment or other illegal payment at any time.

4K. *Title to Property*

(a) The Company and/or one of the Subsidiaries holds good and marketable title to the real property identified as owned by the Company or such Subsidiary on the *Owned Property Schedule*, and such title is subject only to (i) utility liens, (ii) liens for taxes not yet due and payable, (iii) covenants, conditions and restrictions of record which are not violated in any material respect by existing uses or improvements and which do not interfere with the current use and/or occupancy of the real estate nor impair or adversely affect the merchantability thereof and (iv) matters shown as title exceptions on the *Permitted Encumbrances Schedule* or the *Encumbrances Schedule*, as the case may be.

(b) Except as set forth on the *Leased Property Schedule* attached hereto, the leases relating to the property identified as leased by the Company or one of the Subsidiaries on the *Leased Property Schedule* are in full force and effect and the Company or such Subsidiary holds a valid and existing leasehold interest under each such lease. Sellers have made available to Buyer complete and accurate copies of each of the leases relating to real property identified as leased by the Company or one of the Subsidiaries on the *Leased Property Schedule* and one of such leases has been modified, except to the extent that such modifications are disclosed by the copies delivered to Buyer. The Company is not in default under, nor is there any default by the lessor under, nor does any Person have the right to terminate, accelerate performance under or

otherwise modify (including upon the giving of notice or the passage of time), any of such leases.

(c) The property described on the *Owned Property Schedule* and the *Leased Property Schedule* attached hereto constitute all of the real property owned, leased, used or occupied by the Company or one of the Subsidiaries.

(d) Except for the encumbrances (i) reflected on the Latest Balance Sheet, (ii) relating to current taxes not yet due and payable, (iii) set forth on the *Owned Property Schedule* or the *Encumbrance Schedule*, the Company owns good and marketable title, free and clear of all liens, charges, security interests and encumbrances, to all of the personal property and assets shown on the Latest Balance Sheet, or acquired thereafter or located on the Company's or either Subsidiary's premises.

(e) The buildings, improvements, fixtures, machinery, equipment, and other tangible assets of the Company and the Subsidiaries (whether owned or leased) located on the real property listed on the *Owned Property Schedule* or the *Leased Property Schedule* attached hereto are, except for ordinary wear and tear, in good condition and repair and are usable in the ordinary course of business. The Company or one of the Subsidiaries own or lease under valid leases all buildings and all such machinery, equipment and other tangible assets necessary to conduct their respective businesses in conformity with past practices, the Company and the Subsidiaries have good and marketable title to all such assets owned by them, and, all such assets have been installed and maintained in compliance with all applicable laws, regulations and ordinances, except where noncompliance with such laws,

regulations and ordinances will not result in material Losses to the Company and the Subsidiaries (which Losses shall be deemed "material" for purposes of this Section 4K(e) only in the event and then only to the extent that such Losses in the aggregate exceed $30,000).

(f)(i) Except as set forth on the *Compliance Schedule* attached hereto, neither the Company nor either Subsidiary is in violation of any applicable health, safety or zoning ordinance relating to the operation of the real property listed on the *Owned Property Schedule* or the *Leased Property Schedule* attached hereto, other than the Company's owned real property located in DeKalb, Illinois (the "DeKalb Property"). Except as set forth on the *Compliance Schedule*, neither the Sellers, the Company, nor either Subsidiary have received any notice of any violation of any health, safety or zoning law, regulation or requirement within twelve months prior to the date hereof relating to the operation of the real property listed on the *Owned Property Schedule* or the *Leased Property Schedule* attached hereto. None of the real property listed on the *Owned Property Schedule* and the *Leased Property Schedule* attached hereto, other than the DeKalb Property, is classified as a "permitted non-conforming use" or "permitted non-conforming structure" under applicable zoning ordinances.

(ii) To the best knowledge of the Sellers, neither the Company nor either of the Subsidiaries are in violation of any applicable zoning ordinance relating to the operation of the DeKalb Property. Except as set forth on the *Compliance Schedule*, neither the Company nor any of the Subsidiaries are in violation of any applicable health or safety ordinance relating to the operation of the

DeKalb Property. To the best knowledge of the Sellers, none of the DeKalb Property is classified as a "permitted non-conforming use" or "permitted non-conforming structure" under applicable zoning ordinances.

(g) Except as disclosed on the *Owned Property Schedule* or the *Leased Property Schedule*, as the case may be, the real property listed on the *Owned Property Schedule* and the *Leased Property Schedule* attached hereto has unqualified access by legal, valid and irrevocable easements to public roads and to all utilities, including electricity, sanitary and storm sewers, portable water, natural gas and other utilities used in the operation of the Company's and the Subsidiaries' respective businesses.

(h) Neither the Company, any of the Subsidiaries nor the Sellers have received any notice of the existence of any pending or contemplated condemnation or eminent domain proceeding with respect to the real property listed on the *Owned Property Schedule* or the *Leased Property Schedule* attached hereto within the three years prior to the date hereof.

4L. *Tax Matters*. The Company and the Subsidiaries have timely filed all federal, foreign, state, county and local income, excise, property and other tax returns which are required to be filed by them; all such returns are true and correct; all taxes of any kind (including any interest or penalties with respect thereto) due and owed by the Company and the Subsidiaries or which the Company and the Subsidiaries are obligated to withhold from amounts owing to any employee, creditor or third party, as of the date of this Agreement, have been paid or are accrued on the Latest Balance Sheet and, as of December

31, 1989, all such taxes as of December 31, 1989 will have been paid or will be accrued on Final Balance Sheet; neither the Company nor either Subsidiary has waived any statute of limitations or agreed to the extension of time with respect to a tax assessment or deficiency; the assessment of additional taxes is not expected for prior periods; and, to the best knowledge of the Sellers, there exists no unresolved questions or claims concerning tax liabilities of the Company or either Subsidiary. The federal income tax returns of the Company and the Subsidiaries has been audited by the Internal Revenue Service, or the statutes of limitation with respect to such federal income taxes have expired, for all fiscal years to and including December 31, 1985. Neither the Company nor either of the Subsidiary have ever filed a consent or election under Section 341(f) of the Internal Revenue Code relating to collapsible corporations. Neither the Company nor either Subsidiary is a party to or bound by any agreement relating to the allocation or payment of taxes with the Sellers or any other Person. Neither the Company nor either Subsidiary is required to include in its taxable income for any taxable year ending after the Closing any adjustment under Section 481 of the Internal Revenue Code of 1986 or any similar provision or rule of law.

4M. *Contracts and Commitments.*

(a) Except as set forth on the *Contracts Schedule* attached hereto, neither the Company nor either Subsidiary is a party to any written or oral:

(i) contract with any labor union or any bonus, pension, profit sharing, retirement or any other form of

deferred compensation plan or any stock or partnership interest purchase, stock or partnership interest option plan, hospitalization insurance plan or similar plan or practice, whether formal or informal, or any severance agreements;

(ii) written contract for the employment of any officer, partner, individual employee or other Person on a full-time, part-time or consulting basis;

(iii) agreement or indenture relating to borrowing of money or to mortgaging, pledging or otherwise placing a lien on any of the Company's or either Subsidiary's assets;

(iv) agreements with respect to the lending or investing of funds;

(v) license or royalty agreements;

(vi) guaranty of any obligation for borrowed money or otherwise, other than endorsements made for collection;

(vii) lease or agreement under which it is lessee of or hold or operate any personal property owned by any other party for which the annual rental exceeds $10,000;

(viii) lease or agreement under which it is lessor of or permit any third party to hold or operate any property, real or personal, owned or controlled by it for which the annual rental exceeds $10,000;

(ix) contract or group of related contracts (except oral contracts terminable within 30 days or less without penalty) with the same party for the purchase or

sale of products or services under which the undelivered balance of such products and services has a selling price in excess of $50,000, other than purchase orders or sale orders entered into in the ordinary course of business on the standard forms set forth on *Exhibit 4M* attached hereto;

(x) other contract or group of related contracts (except oral contracts terminable within 30 days or less without penalty) with the same party continuing over a period of more than six months from the date or dates thereof involving more than $50,000, other than purchase orders or sale orders entered into in the ordinary course of business on the standard forms set forth on *Exhibit 4M*;

(xi) contract which prohibits it from freely engaging in business anywhere in the world;

(xii) contract relating to the distribution of its products which obligates any party thereto to make payments in excess of $50,000 during or with respect to any 12 month period, other than purchase orders or sale orders entered into in the ordinary course of business on the standard forms set forth on *Exhibit 4M*;

(xiii) contract with any officer, director, shareholder, or other affiliate (except contracts terminable within 30 days or less without penalty); or

(xiv) other agreement material to the business of the Company or either Subsidiary, whether or not entered into in the ordinary course of business.

(b) Except as specifically disclosed in the *Contracts Schedule* attached hereto, (i) to the best of Sellers' knowledge, no contract or commitment set forth on the *Contracts Schedule*, nor any of those not required to be disclosed thereon, has been breached in any respect or cancelled by any other party since the date of the Latest Balance Sheet, and since the date of the Latest Balance Sheet, none of the Company's or any of the Subsidiaries' ten most significant customers or suppliers has indicated to the Sellers that it will stop or decrease the rate of business done with the Company or such Subsidiary, and (ii) the Company and each of the Subsidiaries have performed all obligations under the contracts listed on the *Contracts Schedule*, nor any of those not required to be disclosed thereon, required to be performed by them and there is no default under any lease, contract, commitment or other agreement to which any of them is a party or any event which, upon given of notice or lapse of time, would constitute such a default.

(c) The *Contracts Schedule* sets forth each contract, commitment or obligation of the Company and each of the Subsidiaries which is secured by a letter of credit or guarantee (other than guarantees by the Company or obligations of the Subsidiaries) and the nature and amount of such security.

(d) Buyer has been supplied with a true and correct copy of all written contracts which are referred to on the *Contracts Schedule* attached hereto, together with all amendments, waivers or other changes thereto. The *Contracts Schedule* contains a description of all material terms of all oral contracts required to be set forth on the *Contracts Schedule*.

4N. *Proprietary Rights*. The *Proprietary Rights Schedule* attached hereto contains a complete and accurate list of all patented and registered Proprietary Rights of the Company and the Subsidiaries and identifies all pending patent applications and applications for registration of other Proprietary Rights owned or filed by or for the Company and the Subsidiaries. The *Proprietary Rights Schedule* also contains a complete and accurate list of all licenses and other rights granted by the Company or any Subsidiary to any third party with respect to Proprietary Rights and licenses and other rights granted by any third party to the Company or either Subsidiary. Except as set forth on the *Proprietary Rights Schedule*:

(a) the Company and the Subsidiaries each own or have the valid right to use all Proprietary Rights necessary for the operation of their respective businesses as now conducted or as currently proposed to be conducted;

(b) the loss or expiration of any Proprietary Right or related group of Proprietary Rights would not have a material adverse effect on the conduct of the Company's or either of the Subsidiary's business and no such loss or expiration is threatened, pending or reasonably foreseeable;

(c) the Company and/or one of the Subsidiaries own and possess all right, title and interest in and to the Proprietary Rights, and no claim by any third party contesting the validity, enforceability, use or ownership of any rights set forth in the Proprietary Rights Schedule has been made, is currently outstanding or is threatened;

(d) no Seller nor any executive of the Company or either Subsidiary has received any notices of, or is aware

of any facts which indicate a likelihood of, any infringement or misappropriation by, or conflict with, any third party with respect to the rights set forth in the Proprietary Rights Schedule; and

(e) neither the Company nor either Subsidiary has infringed, misappropriated or otherwise conflicted with any rights of any third parties, or is aware of any infringement, misappropriation or conflict which will occur as a result of the continued operation of the businesses of the Company and Subsidiaries as now conducted or as currently proposed to be conducted.

4O. *Litigation.* Except as set forth in the *Litigation Schedule* attached hereto, (i) there are no actions, suits, proceedings, orders or investigations pending or, to the best of Sellers' knowledge, threatened against or affecting the Company or either Subsidiary at law or in equity, or before or by any federal, state, municipal or other governmental department, commission, board, bureau, agency or instrumentality, domestic or foreign (including without limitation, with respect to applicable workmen's compensation laws and regulations), and there is no reasonable basis known to the Sellers for any of the foregoing, and (ii) neither the Company, either Subsidiary nor the Sellers have received any opinion or legal advice in writing, within the three years preceding the date hereof, to the effect that the Company or any of the Subsidiaries are exposed from a legal standpoint to any liability or disadvantage which may be material to its business as previously or presently conducted. The Company and each of the Subsidiaries are fully insured with respect to each of the matters set forth on the *Litigation Schedule*.

4P. *Brokerage.* Except as set forth on the *Seller Brokerage Schedule* attached hereto, there are no claims for brokerage commissions, finders' fees or similar compensation in connection with the transactions contemplated by this Agreement based on any arrangement or agreement made by or on behalf of the Sellers, the Company or either Subsidiary.

4Q. *Government Consent, etc.* Except for the filing pursuant to the HSR Act, and expiration or early termination of the statutory waiting period in connection therewith, no permit, consent, approval or authorization of, or declaration to or filing with, any governmental or regulatory authority is required in connection with the execution, delivery or performance of this Agreement by the Sellers or the consummation by the Sellers of any other transaction contemplated hereby.

4R. *Employees.* To the best of Sellers' knowledge, except for Arthur L. Gustafson, Daniel R. McLean, Francis L. Butler, William Lord and Henry Young, no key employee and no group of employees of the Company or either Subsidiary has any plans to terminate or modify his or her employment with the Company or such Subsidiary. Except as set forth on the *Compliance Schedule* attached hereto, the Company and each of the Subsidiaries have complied with all applicable laws relating to the employment of labor, including, without limitation, provisions thereof relating to wages, hours, equal opportunity, collective bargaining and the payment of social security and other taxes, and within the last five years neither the Company nor either Subsidiary has experienced any strikes, grievances, unfair labor practices

claims or other labor relations problems, including, without limitation, any disputes with former employees regarding termination and/or severance pay. Except as set forth in the *Employee Contracts Schedule* attached hereto, and except as otherwise expressly contemplated by this Agreement, neither the Company nor either Subsidiary has entered into any oral or written employment agreements not terminable by the Company or such Subsidiary on less than 30 days notice and without any penalty or additional payments. To the best of the Sellers' knowledge, (i) there are no claims, actions, proceedings or investigations pending or threatened against any of the employees of the Company or either Subsidiary and (ii) no employee of the Company or either Subsidiary is subject to any non-compete or nondisclosure agreement.

4S. *Related Party Transactions.* Except as described on the *Related Party Schedule* attached hereto, neither the Company nor either Subsidiary is a party to any agreement or transaction with any Related Party. "Related Party" means any Person or entity controlled by, controlling or under common control with the Company or either Subsidiary and shall include the Sellers and their affiliates.

4T. *Employee Benefit Plans.*

(a) With respect to current or former employees of the Company or either Subsidiary, neither the Company nor either Subsidiary maintains or contributes to any (i) nonqualified deferred compensation or retirement plans or arrangements, (ii) qualified defined benefit plans (including multiemployer pension plans) or arrangements which are employee pension benefit plans (as

defined in Section 3(2) of the Employee Retirement Income Security Act of 1974 ("ERISA")) or (iii) employee welfare benefit plans (as defined in Section 3(a) of ERISA) which provide health, accident or life insurance benefits to former employees, their spouses or dependents, other than in accordance with Section 4980(B) of the Internal Revenue Code of 1986 (the "Code"). Neither the Company nor either Subsidiary maintains or contributes to, or has within the last five years maintained or contributed to, any defined benefit pension plan or contributed to any multiemployer pension plan (as defined in Section 3(37) of ERISA). Except as set forth on the *Employee Benefits Schedule*, neither the Company nor either Subsidiary maintains or contributes to any qualified defined contribution plans or arrangements which are employee pension benefit plans, any employee welfare benefit plans, or any material fringe benefit plans or programs.

(b) The Alloyd Co., Inc. Profit Sharing Plan & Trust (the "Profit Sharing Plan") and all employee welfare benefit plans (and related trusts and insurance contracts) comply in form and in operation in all respects with the applicable requirements of ERISA and the Code. The Profit Sharing Plan meets the requirements of a "qualified plan" under Section 401(a) of the Code and, except as set forth on the *Compliance Schedule*, has received a favorable determination letter from the Internal Revenue Service.

(c) Except as set forth on the *Compliance Schedule*, all required reports and descriptions (including Form 5500 Annual Reports, Summary Annual Reports and Summary Plan Descriptions) with respect to the Profit Sharing Plan and all employee welfare benefit plans have been properly filed with the appropriate government agency or

distributed to participants, and the Company has complied with the requirements of Section 4980(B) of the Code.

(d) Neither the Company nor either subsidiary has incurred any liability to the Pension Benefit Guaranty Corporation ("PBGC"), the Internal Revenue Service or any multiemployer plan with respect to any employee pension benefit plan. Except as otherwise expressly contemplated hereby, no separation, severance termination or similar type benefit will become payable to any employee of the Company or either Subsidiary solely as a result of any transaction contemplated by this agreement.

(e) With respect to the Profit Sharing Plan, all contributions for prior plan years have been made, and with respect to the current plan year all contributions declared by the Company's or any Subsidiary's board of directors have been made. Neither the Company nor any Subsidiary has any outstanding obligation to make any contributions to the Profit Sharing Plan with respect to any plan year or portion thereof prior to the Closing Date.

(f) With respect to the Profit Sharing Plan and each employee welfare benefit plan, (i) there have been no prohibited transactions as defined in Section 406 of ERISA or Section 4975 of the Code, (ii) no fiduciary (as defined in Section 3(21) of ERISA) has any liability for breach of fiduciary duty or any other failure to act or comply in connection with the administration or investment of the assets of such plans, and (iii) no actions, investigations, suits or claims with respect to the assets thereof (other than routine claims for benefits) are pending or threatened, and the Sellers have no knowledge of

any facts which would give rise to or could reasonable [sic] be expected to give rise to any such actions, suits or claims.

(g) With respect to the Profit Sharing Plan and to each employee welfare benefit plan, Sellers have furnished or made available to Buyer true and complete copies of (i) the plan documents and summary plan descriptions, (ii) except as set forth on the *Compliance Schedule*, the most recent determination letter received from the Internal Revenue Service, (iii) the last Form 5500 Annual Report, and (iv) all related trust agreements, insurance contracts or other funding agreements which implement such plans.

4U. *Officers and Directors: Bank Accounts.* The *Officers and Directors Schedule* attached hereto lists all officers and directors of the Company and the Subsidiaries, The attached *Bank Accounts Schedule* lists all of the bank accounts, safe deposit boxes and lock boxes of the Company and the Subsidiaries (designating each authorized signer). Neither the Company nor either Subsidiary has granted a power of attorney to any Person or entity which has not been terminated. To the best knowledge of Sellers, there are no claims actions, proceedings or investigations pending or threatened against any of the officers, directors or partners of the Company or either Subsidiary with respect to the Company's or either Subsidiary's business.

4V. *Insurance.* True and correct copies of each insurance policy maintained by the Company and each of the Subsidiaries with respect to their properties, assets and businesses have, been made available to Buyer. All of the

Company's and the Subsidiaries' insurance policies are in full force and effect, and neither the Company nor either Subsidiary is in default with respect to its obligations under any of such insurance policies. If between the date hereof and the Closing Date, the Company or either Subsidiary desire to alter any insurance policy, the Company or such Subsidiary, as the case maybe [sic], must obtain Buyer's prior written consent to any such change, which consent will not be unreasonably withheld.

4W. *Compliance with Laws: Permits: Certain Operations.*

(a) Except as set forth on the *Compliance Schedule* attached hereto, except for the environmental matters addressed in Section 4W(b) below, and except for matters which will not result in material Losses to the Company and the Subsidiaries (which Losses shall be deemed "material" for purposes of this Section 4W(a) only in the event and then only to the extent such Losses in the aggregate exceed $30,000);

(i) The Company, the Subsidiaries, and their respective officers, directors, partners, agents and employees have complied with all applicable laws, ordinances, rules, requirements and regulations of foreign, federal, state and local governments and all agencies thereof which affect the businesses, operation or any owned or leased properties of the Company and the Subsidiaries and to which the Company and the Subsidiaries may be subject, and no notices have been received by, and no claims have been filed against the Company or either Subsidiary alleging a violation of any such laws, ordinances, rules, requirements or regulations;

(ii) Each of the Company and the Subsidiaries holds all of the permits, licenses, certificates or other authorizations of foreign, federal, state and local governmental agencies required for the conduct of its business. In particular, but without limiting the generality of the foregoing, each of the Company and the Subsidiaries has obtained all material permits, licenses and other authorizations which are required under federal, state and local laws relating to public health and safety and worker health and safety;

(iii) The Company and the Subsidiaries are in compliance with all terms and conditions of any and all required permits, licenses and authorizations, and are also in compliance with all other limitations, restrictions, conditions, standards, prohibitions, requirements, obligations, schedules and timetables contained in any foreign, federal, state or local law or any regulation, code, plan, order, decree or judgment relating to public health and safety and worker health and safety, or any notice or demand letter issued, entered, promulgated or approved thereunder; and

(iv) No facts, events or conditions interfere with or prevent continued compliance with, or give rise to any present or potential legal, common law or statutory liability under, any law or regulation relating to public health and safety and worker health and safety to which the Company or either Subsidiary is a party, subject or bound.

(b) Without limiting the generality of Section 4W(a) above, except as set forth on the *Compliance Schedule*: (i) the Company and each of the Subsidiaries have obtained

all permits, licenses and other authorizations which are required under foreign, federal, state and local laws relating to pollution or protection of the environment, including laws relating to emissions, discharges, releases or threatened releases of pollutants, contaminants or hazardous or toxic materials or wastes into ambient air, surface water, ground water, or lands or otherwise relating to the manufacture, processing, distribution, use, treatment, storage, disposal, transport or handling of pollutants, contaminants or hazardous or toxic materials or wastes; (ii) the Company and each of the Subsidiaries are in compliance with all terms and conditions of any and all required permits, licenses and authorization, and are also in compliance with all other limitations, restrictions, conditions, standards, prohibitions, requirements, obligations, schedules and timetables contained in any federal, state or local law or any regulations, code, plan, order, decree or judgment relating to pollution or protection of the environment or any notice or demand letter issued, entered, promulgated or approved thereunder; (iii) no facts, events or conditions interfere with or prevent continued compliance with, or give rise to any legal, common law or statutory liability under, any current or prior applicable law or regulation related to the disposal, storage, transport or handling, or related to the emission, discharge, release or threatened release into the environment, of any pollutant, contaminant, or hazardous or toxic material or waste, and (iv) neither the Company nor either Subsidiary has knowingly or unknowingly nor, to the best knowledge of the Sellers, has any predecessor of the Company or either Subsidiary or any previous owner of the parcels of real property described on the *Owned*

Property Schedule, stored, handled, disposed of or released or emitted into the environment any chemical or toxic material or waste or hazardous material or petroleum or crude oil or fraction thereof in any manner which may form the basis for any claim, demand or action under any current or prior applicable law or regulation seeking cleanup of any site, location or body of water, surface or subsurface. There are no abandoned, closed or not-in-service underground storage tanks located on the real property described on the *Owned Property Schedule*.

4X. *Product Warranty*. Each product manufactured, sold, leased or delivered by the Company or either Subsidiary has been in conformity with all applicable contractual commitments and all express and implied warranties. Except for matters which will not result in material Losses to the Company and the Subsidiaries (which Losses shall be deemed "material" for purposes of this Section 4X only in the event and then only to the extent such Losses in the aggregate exceed $30,000), no liability exists for replacement or repair of such products or other damages in connection therewith and no products manufactured, sold, leased or delivered by the Company or either Subsidiary are subject to any guaranty, warranty or other indemnity beyond the applicable standard terms and conditions of sale or lease.

4Y. *Product Liability*. Except as set forth on the *Litigation Schedule*, there is not existing liability, claim or obligations arising from or alleged to arise from any actual or alleged injury to persons or property as a result of the ownership, possession or use of any of the products manufactured, sold, leased or delivered by the Company or either Subsidiary.

4Z. *Disclosure.* Neither this Agreement, nor any of the Schedules, attachments or exhibits hereto, contain any untrue statement of a material fact or omit a material fact necessary to make the statements contained herein or therein, in light of the circumstances in which they were made, not misleading. There is no material fact which has not been disclosed to Buyer of which the Sellers or the officers or directors of the Company or either Subsidiary are aware and which materially adversely affects the Company's or either Subsidiary's business, financial condition, operating results, assets, operations or business prospects.

4AA. *Closing Date.* All of the representations and warranties of Sellers in this Article IV and elsewhere in this Agreement all information delivered in any schedule, attachment or exhibit hereto or in any certificate delivered to Buyer are true and correct on the date of this Agreement and will be true and correct at the Closing Date as though then made and as though the Closing Date were substituted for the date of this Agreement throughout such representations and warranties, except for representations and warranties expressly made as of a date other than the date hereof, in which case such representations and warranties will be true and correct as of such date only.

ARTICLE V

REPRESENTATIONS AND WARRANTIES OF BUYER

5A. *Corporate Organization and Power.* Buyer is a corporation duly organized and validly existing under the laws of the State of Delaware, with full corporate power

and authority to enter into this Agreement and perform its obligations hereunder.

5B. *Authorization: No Breach.* The execution, delivery and performance of this Agreement by Buyer and the consummation of the transactions contemplated hereby have been duly and validly authorized by all requisite corporate action on the part of Buyer, and no other corporate proceedings on the part of Buyer are necessary to authorize the execution, delivery, or performance of this Agreement. This Agreement, the Notes and the Escrow Agreement to be delivered in connection herewith constitute valid and binding obligations of Buyer, enforceable in accordance with their respective terms, except as may be limited by applicable debtor relief laws and general principles of equity.

5C. *No Violation.* Buyer is not subject to or obligated under its certificate of incorporation, its by-laws, any applicable law, or rule or regulation of any governmental authority, or any agreement or instrument, or any license, franchise or permit, or subject to any order, writ, injunction or decree, which would be breached or violated by its execution, delivery or performance of this Agreement, except to the extent valid consents and approvals or waivers have been obtained. Buyer will comply with all applicable laws and with all applicable rules and regulations of all governmental authorities in connection with its execution, delivery and performance of this Agreement and the consummation of the transactions contemplated hereby.

5D. *Governmental Authorities and Consents.* Except for the filing pursuant to the HSR Act, and expiration or

early termination of the statutory waiting period in connection therewith, Buyer is not required to submit any notice, report or other filing with any governmental authority in connection with the execution or delivery by it of this Agreement or the consummation of the transactions contemplated hereby. Except for the filing pursuant to the HSR Act, and expiration or early termination of the statutory waiting period in connection therewith, no consent, approval or authorization of any governmental or regulatory authority or any other party or Person is required to be obtained by Buyer in connection with its execution, delivery and performance of this Agreement or the transactions contemplated hereby.

5E. *Brokerage.* Except as set forth on the *Buyer Brokerage Schedule* attached hereto, there are no claims for brokerage commissions, finders' fees or similar compensation in connection with the transactions contemplated by this Agreement based on any arrangement or agreement made by or on behalf of Buyer.

5F. *Litigation.* There are no actions, suits, proceedings, orders or investigations pending or, to the best of Buyer's knowledge, threatened against or affecting Buyer at law or in equity, or before or by any federal, state, municipal or other governmental department, commission, board, bureau, agency or instrumentality, domestic or foreign, which would adversely affect Buyer's performance under this Agreement or the consummation of the transactions contemplated hereby.

5G. *Notification.* From the date hereof to the Closing, Buyer will promptly inform the Sellers' Spokesperson in writing of any material variance from the

representations and warranties contained in this Article V.

5H. *Investment Purpose.* Buyer is purchasing the Purchased Shares hereunder for its own account and not with a view to, or present intention of, distribution thereof in violation of the Securities Act of 1933, as amended (the "1933 Act"). The Buyer believes that it has had a reasonable opportunity to ask questions of and receive information and answers from the Sellers or Persons acting on behalf of the Sellers concerning this Agreement and the transactions contemplated herein.

5I. *Disclosure.* There is no material fact of which Buyer has actual knowledge which materially adversely affects the Company's or the Subsidiaries' businesses or operations or which would otherwise if disclosed to Sellers cause a breach under the Sellers' representations, warranties, covenants and agreements contained herein. For the purposes of this Agreement, the "actual knowledge" of Buyer shall mean the actual knowledge of the general partners of Wind Point Partners II. L.P.

ARTICLE VI

TERMINATION

6A. *Termination.* This Agreement may be terminated at any time prior to the Closing,

(a) by mutual consent of Buyer and the Sellers' Spokesperson, on behalf of the Sellers;

(b) by either Buyer or the Sellers' Spokesperson, on behalf of the Sellers, if there has been a material misrepresentation, material breach of warranty or material

breach of a covenant on the part of the other party in the representations and warranties or covenants set forth in this Agreement which has not been cured prior to such termination; or

(c) by either Buyer or the Sellers' Spokesperson, on behalf of the Sellers, if the transactions contemplated hereby have not been consummated by January 15, 1990; *provided* that neither Buyer nor the Sellers' Spokesperson, on behalf of the Sellers, will be entitled to terminate this Agreement pursuant to this Section 6A(c) if such party's breach of this Agreement has prevented the consummation of the transactions contemplated hereby.

6B. *Effect of Termination.* In the event of termination of this Agreement by either Buyer or the Sellers' Spokesperson, on behalf of the Sellers, as provided above, this Agreement will forthwith become void and there will be no liability on the part of either Buyer or Sellers, except for breaches of this Agreement prior to the time of such termination, and except that the covenants and agreements set forth in Sections 1E, 7D and 7G shall survive such termination indefinitely.

ARTICLE VII

ADDITIONAL AGREEMENTS

7A. *Survival of Representations and Warranties.* The representations and warranties set forth in this Agreement or in any writing delivered by Buyer or the Sellers to the other party in connection with this Agreement will survive the Closing Date for a period which commences on the Closing Date and continues up to and including

April 30, 1991, and shall not be affected by any examination made for or on behalf of Buyer or the Sellers, or the knowledge of any of Buyer's or the Company's officers, directors, shareholder, employees or agents, except as otherwise provided herein or as has been specifically disclosed in the Schedules attached hereto; *provided*, that (i) the representations and warranties made by the Sellers in Sections 4B, 4L and 4P hereof shall survive the Closing Date and continue in full force and effect indefinitely, (ii) the representations and warranties made by the Sellers in Section 4W(b) shall survive the Closing Date and continue in full force and effect for a period of three years following the Closing Date.

7B. *Indemnification.*

(a) Subject to the limitations set forth in Section 7B(b) below, the Sellers jointly and severally (but severally only with respect to the matters set forth in Section 7B(d)) agree to indemnify Buyer and hold it harmless against any loss, liability, penalty, deficiency, damage or expense (including reasonable legal expenses and costs) (individually, a "Loss" and collectively, the "Losses") which Buyer or its subsidiaries (including, after the Closing, the Company and the Subsidiaries) may suffer, sustain or become subject to, as a result of (i) the breach by the Sellers of any representation or warranty made by the Sellers contained in Article IV of this Agreement (other than the representations and warranties contained in Section 4B, and 4P); (ii) the breach by the Sellers of any representation and warranty contained in Section 4B and 4P; (iii) the breach by the Sellers of any representation,

warranty (other than representations or warranties contained in Article IV hereof), covenant or agreement contained in this Agreement or any agreements contemplated hereby or any Exhibit hereto, including, without limitation, subject to Section 7B(d) below, the Non-Compete Agreement and the provisions contained in Section 5 of the Executive Employment Agreements; (iv) any franchise tax or corporate income tax liabilities arising from the failure of the Company or any Subsidiary to qualify to do business as a foreign corporation in and file income tax returns with the States of Florida, Michigan and Tennessee, (v) the removal prior to the Closing Date of underground storage tanks and any associates soil and ground water contamination located on the DeKalb Property, including, without limitation, the assessment and remediation on or after the Closing Date of any contamination associated with the Stoddard solvent tanks; (vi) the litigation matters set forth on the *Litigation Schedule*, to the extent Buyer is not fully reimbursed for any Losses resulting from or related to such litigation matters by the Company's current insurance carriers pursuant to the Company's insurance policies in effect as of the Closing Date; and (vii) any loss, impediment or interference with, of or to any utility service necessary to the use, occupancy and ownership of the real property set forth on the *Owned Property Schedule* (the "Owned Real Property"), including, without limitation, sewer, gas, water, electricity and telephone service, in any way related to the absence of legal, irrevocable appurtenant easements serving or encumbering the Owned Real Property.

(b) Sellers' obligations to indemnify Buyer pursuant to Section 7B(a) above shall be subject to the following limitations:

(i) Sellers will be liable to indemnify Buyer with respect to claims referred to in Sections 7B(a)(i), 7B(a)(iv), 7B(a)(vi) and 7B(a)(vii) above only to the extent that the aggregate amount of Losses for which Buyer would otherwise be entitled to indemnification with respect to such claims under this Section 7B exceeds $500,000.

(ii) Sellers will be liable to indemnify Buyer with respect to the claims referred to in Section 7B(a)(i) and 7B(a)(vii) only if, (x) with respect to claims for breaches of the representations and warranties set forth in Section 4A, 4C through 4K, 4M through 4O, 4Q through 4W(a) and 4X through 4AA, Buyer gives written notice thereof to the Sellers on or prior to April 30, 1991, (y) with respect to claims arising from the matters set forth in Section 7B(a)(vii) above, Buyer gives written notice thereof to the Sellers within five years after the Closing Date, and (z) with respect to claims for breaches of the representations and warranties set forth in Section 4W(b), Buyer give [sic] written notice thereof to the Sellers within three years after the Closing Date.

(iii) Sellers shall not be liable to indemnify Buyer with respect to claims referred to in Sections 7B(a)(i), 7B(a)(iii) through 7B(a)(vii) above to the extent that the aggregate Purchase Price delivered by Buyer to the Sellers pursuant to Section 1B(b) and 1C(a); provided, that the foregoing limitation shall not apply with respect

to any Losses arising from a breach of the representations and warranties set forth in Section 4B.

(c) Buyer's rights to indemnification set forth in this Section 7B are in addition to any other remedies that Buyer may otherwise have against the Sellers at law or in equity for Sellers' breach of the representations, warranties, covenants and agreements made by the Sellers in this Agreement or any Exhibit hereto. In addition to any other such remedy Buyer may have against the Sellers, including, without limitation, Buyer's express right to proceed against any Seller on a joint and several (several, with respect to the matters set forth in Section 7B(d)) basis for any claim for indemnification Buyer may have against such Seller pursuant to Section 7B(a) hereof, Buyer may satisfy any claim for indemnification it may have against the Sellers by exercising either or both of the following remedies:

(i) Pursuant to the provisions of the Notes, Buyer may offset any amounts due or to become due under the Notes against any claim for indemnification made by Buyer against the Sellers pursuant to this Section 7B or otherwise at law or in equity. Any such offset shall effect the timing and amount of payments required under the Notes in the same manner as if Buyer had made a permitted prepayment pro rata thereunder; and

(ii) In accordance with the terms of the Escrow Agreement, Buyer may make a claim against the Escrow Fund for any claim for indemnification made by Buyer against the Sellers pursuant to this Section 7B or otherwise at law or in equity.

Notwithstanding the foregoing provisions of this Section 7B(c), to the extent that the Escrow Fund is sufficient to satisfy a Loss, Buyer shall, prior to the exercising any right of offset against the Notes and prior to exercising any of Buyer's other remedies against the Seller's, including, without limitation, Buyer's express right to proceeds against any Seller on a joint and several (several, with respect to the matters set forth in Section 7B(d)) basis for any claim for indemnification Buyer may have against such Seller pursuant to Section 7B(a) hereof, first make a claim for such Loss against the Escrow Fund in accordance with the terms of the Escrow Agreement; *provided*, however, that nothing herein shall prohibit Buyer from making an offset against the Notes or exercising any of Buyer's other remedies against the Sellers simultaneously with a claim against the Escrow Fund to the extent that the Escrow Fund is insufficient to satisfy any Loss. Notwithstanding anything to the contrary in this Section 7B, including any contrary implications created by this Section 7B(c), Buyer hereby expressly waives any and all rights it may have to seek the remedy of recision against the Sellers in connection with the Sellers' breach of any provision of this Agreement or any Exhibit hereto.

(d) Notwithstanding anything in this Section 7B to the contrary, each Seller's obligation to indemnify Buyer for such Seller's breach of the representations and warranties set forth in Section 4B(ii), Gustafson's obligation to indemnify Buyer for any breach by Gustafson of the Non-Compete Agreement, McLean's obligation to indemnify Buyer for any breach by McLean of the provisions contained in Section 5 of the Executive Employment Agreement to which he is a party, and Butler's obligation

to indemnify Buyer for any breach by Butler of the provisions contained in Section 5 of the Executive Employment Agreement to which he is a party, are each several and not joint in nature.

(e) Subject to Section 7B(f) below, Buyer agrees to indemnify the Sellers and hold them harmless against any Losses which Sellers may suffer, sustain or become subject o [sic], as the result of a breach of any representation, warranty, covenant or agreement by Buyer contained in this Agreement or any Exhibit hereto.

(f) The indemnification provided in Section 7B(e) above is subject to the following limitations with respect to claims for breaches of any representation or warranty contained in Article V:

(i) Buyer will be liable to the Sellers for any Losses only if the aggregate amount of Losses exceeds $250,000.

(ii) Buyer will not be liable to the Sellers for any Losses arising from any such breach unless written notice specifying the nature of such claim is given by the Sellers' Spokesperson to Buyer on or prior to April 30, 1991.

(g) The party seeking indemnification (the "Indemnified Party") agrees to give the party from whom indemnification is sought (the "Indemnifying Party") timely notice with reasonably available detailed particulars of any claim with respect to which the Indemnifying Party has agreed to indemnify the Indemnified Party under this Section 7B; *provided*, that any delay in the giving of such notice will not relieve the Indemnifying Party from liability under this Section 7B unless and only to the extent

such delay materially damages the Indemnifying Party access to such information possessed by the Indemnified Party as the Indemnifying Party reasonably requests relating to such claim. The Indemnified Party shall initially undertake the defense of any third party claim until the Indemnifying Party has acknowledged in writing that the Indemnifying Party is indemnifying the Indemnified party with respect to any third Party claim, whether or not involving litigation, at which point the Indemnifying Party will be entitled to assume the defense of any such claim; *provided* that the Indemnified Party may at its election participate (as its own expense) in such defense to the extent that in its sole discretion it believes that such claim will affect its ongoing business. At the Indemnifying Party's reasonable request, the Indemnified party will cooperate with the Indemnifying Party in the preparation of any such defense if the Indemnifying Party reimburse the Indemnified Party for any reasonable expenses incurred in connection with such request. The Indemnifying Party will not settle any such claim for consideration other than money without the prior written consent of the Indemnified Party, which shall not be unreasonably withheld.

(h) Notwithstanding any provision of this Agreement to the contrary, any disclosures made by Sellers on the Schedules attached to this Agreement which relate tot he [sic] matters described in Sections 7B(a)(iv) through 7B(a)(vii) hereof shall not in any respect limit Seller's obligation to indemnify Buyer for any Losses as a result of those matters so set forth in Sections 7B(a)(iv) through 7B(a)(vii) hereof.

7C. *Press Release and Announcements.* No press releases or public announcement related to the Agreement and the transactions contemplated herein, or other announcements to the employees, customers and suppliers of the Company or the Subsidiaries will be issued without the prior joint approval of Buyer and the Sellers' Spokesperson.

7D. *Expenses.* Each party hereto will pay all of its own expenses (including, without limitation, the fees and expenses of legal counsel, accountants, investment brokers, brokers or other representatives and consultants and appraisal fees and expenses and other out-of-pocket expenses) in connection with the negotiation and execution of this Agreement, the performance of its obligations hereunder and the consummation of the transactions contemplated by this Agreement (whether consummated or not); *provided*, that the Sellers will pay (i) all sales taxes, transfer taxes, transfer fees, stamp taxes, recording fees and the like arising from the consummation of the transactions contemplated hereby, and (ii) all of the expenses up to $20,000 incurred in connection with their satisfaction of the closing conditions set forth in Sections 2A(o)(ix) and 2A(o)(x) hereof. The Sellers represent and warrant to Buyer that the Company has not, and hereby covenant to the Buyer that the Company will not, be charged for any expenses (including legal fees and costs) incurred by the Sellers or by the Company on behalf of the Sellers, in connection with the negotiation and execution of this Agreement and the consummation of the transactions contemplated by this Agreement (collectively, the "Transaction Expenses") except for such

expenses which are fully reimbursed to the Company by the Sellers on or prior to the Closing Date.

7E. *Further Transfers.* The Sellers will execute and deliver such further instruments of conveyance and transfer and take such additional action as Buyer may reasonably request to effect, consummate, confirm or evidence the transfer to Buyer of the Purchased Shares, and Sellers will execute such documents as may be necessary to assist Buyer in preserving or perfecting its rights in the Purchased Shares. Without limiting the generality of the foregoing, Sellers and Buyer agree to cooperate with each other and to provide each other with all information and documentation reasonably necessary to permit the preparation and filing of all federal, state, local, and other tax returns with respect to the Company; provided that each party shall reimburse the other party for such other party's reasonable out-of-pocket expenses in connection with such other party's compliance with this Section 7E.

7F. *Transition Assistance.* From the date hereof, Sellers will not in any manner take or cause to be taken any action which is designed or intended, or might be reasonably anticipated to have the effect of discouraging customers, suppliers, lessors, and other business associates from maintaining the same business relationships with Buyer, the Company or the Subsidiaries after the date of this Agreement as were maintained with the Company and the Subsidiaries prior to the date of this Agreement.

7G. *Confidentiality.* If the transactions contemplated by this Agreement are not consummated, then in addition to complying with Buyer's obligations under the Letter

Agreement between Wind Point Partners, L.P. and the Company dated October 17, 1989, as amended by the Letter of Amendment dated as of November 1, 1989, Buyer will keep confidential all information and materials regarding the Company and the Subsidiaries reasonably designated by the Sellers as confidential (except to the extent (i) required by law, (ii) the information was previously known to Buyer through a third party not subject to and not otherwise in breach of a confidentiality obligation owed to Sellers, the Company, or a Subsidiary or (iii) the information becomes publicly known except through the actions or inactions of Buyer). Whether or not the transactions contemplated hereby are consummated, the Sellers will return to Buyer and keep confidential all information and materials regarding Buyer reasonably designated by Buyer as confidential (except to the extent (i) required by law, (ii) the information was previously known to the Sellers through a third party not subject to and not otherwise in breach of a confidentiality obligation owed through or (iii) the information becomes publicly known except through the actions or inactions of the Sellers). If the transactions contemplated hereby are consummated, the Sellers will maintain as confidential and will not use or disclose (except as required by law or as authorized in writing by Buyer) any confidential or proprietary information or materials regarding the Company and the Subsidiaries. The Sellers represent and warrant that they have delivered to Buyer all trade secrets, formula and other proprietary information regarding the Company and the Subsidiaries which they possess. The parties hereto agree that money damages would be inadequate for any breach of this Section 7G. Hence, in the

event of either party's breach of this Section 7G, the other party (or its successor or assigns) may, in addition to the other rights and remedies existing in its favor, apply to any court of competent jurisdiction for specific performance and/or injunctive or other relief, in order to enforce, or prevent any violation of, the provisions hereof.

7H. *Investment Representations Regarding the Notes.* In connection with the receipt of the Notes hereunder from Buyer, each of the Sellers hereby represents and warrants to Buyer that:

(a) Such Seller has reviewed this Agreement and the Note;

(b) Such Seller has had an opportunity to ask questions and receive answers concerning the terms and conditions of the offering of the Notes, has had full access to such other information concerning Buyer as such Seller has requested and possesses substantial information about, and familiarity with, the businesses of the Company and the Subsidiaries;

(c) Such Seller has such knowledge and experience in business and financial matters that he is capable of evaluating the merits and risks of the investment in the Notes to be made pursuant to this Agreement, and is able to bear the economic risk of the investment in the Notes for an indefinite period of time;

(d) Such Seller is acquiring the Notes hereunder for his own account with the present intention of holding

such securities for investment purposes and has no intention of selling such securities in a public distribution in violation of federal or state securities laws; and

(e) Such Seller is an "Accredited Investor" as such term is defined in Regulation D promulgated under the Securities Act of 1933.

7I. *Restriction on Transfer of the Notes.* Sellers will not transfer the Notes without the delivery of prior written notice to Buyer describing in reasonable detail the transfer or proposed transfer, together with an opinion (reasonably satisfactory to Buyer) of counsel (reasonably satisfactory to Buyer) to the effect that such transfer may be effected without registration of such Notes under state or federal securities law.

7J. *Regulatory Filings.* The Sellers, the Company and the Buyer shall make or cause to be made all filings and submissions under the HSR Act and any other laws or regulations applicable to any of the Buyer, the Company or any Seller necessary for the consummation of the transactions contemplated herein. The Sellers, the Buyer and the Company will coordinate the cooperate with each other in exchanging such information and will provide such reasonable assistance as each party may request of the other in connection with all of the foregoing.

7K. *Certain Limitations on Buyer's Actions with Respect to Environmental Matters.* Except upon the request or demand of (i) any governmental agency, (ii) any potential buyer of the Company or any substantial portion of the Company's assets or capital stock; or (iii) any investor in or lender to the Company or any Subsidiary, or upon reasonable suspicion of Buyer, in its sole discretion, of the

presence or existence of hazardous, toxic or other materials or substances in or on the soil or groundwater of, at, or below the property owned, leased or operated by the Company or any Subsidiary or the omission, release or discharge or threatened release of such substances or materials, in, on, into or from such property, Buyer will not undertake any sampling or investigations of environmental conditions at such property from the Closing Date until the expiration of the time periods set forth in Sections 7A and 7B for the survival of the representations and warranties made by the Sellers in Section 4V(b).

ARTICLE VIII

MISCELLANEOUS

8A. *Amendment and Waiver.* This Agreement may be amended, or any provision of this Agreement may be waived; *provided* that any such amendment or waiver will be binding on the Sellers only if such amendment or waiver is set forth in a writing executed by Sellers' Spokesperson or in a joint writing executed by each of the Sellers, and that any such amendment or waiver will be binding upon Buyer only if such amendment or waiver is set forth in a writing executed by Buyer. No course of dealing between or among the parties will be deemed effective to modify, amend or discharge any part of this Agreement or any rights or obligations of either party under or by reason of this Agreement.

8B. *Notices.* All notices, demands and other communications to be given or delivered under or by reason of the provisions of this Agreement will be in writing and will be deemed to have been given when (i) personally

delivered, sent by telecopy, overnight express courier or (ii) mailed by certified or registered mail, postage prepaid. Notices, demands and communications to the Sellers and Buyer will, unless another address is specified in writing, be sent to the address indicated below:

Notices to the Sellers:

Sellers' Spokesperson

Arthur L. Gustafson
40W111 Burlington Road
St. Charles, IL 60174; and

Daniel R. McLean
311 Thornbrook
DeKalb, IL 60115

Individually

Arthur L. Gustafson
40W111 Burlington Road
St. Charles, IL 60174

Daniel R. McLean
311 Thornbrook
DeKalb, IL 60115

Francis I. Butler
259 Arlington
Elmhurst, IL 60126

with a copy to:

Vedder, Price, Kaufman & Kammholz
222 North LaSalle Street
Chicago, Illinois 60601
Attn: Thomas P. Desmond, Esq.

with a copy to:

Fitzgerald & Gottlick
55 West Monroe Street, Suite 3401
Chicago, Illinois 60603
Attn: John D. Gottlick, Esq.

Notices to Buyer:

Alloyd Holdings, Inc.
c/o Wind Point Partners, L.P.
1525 Howe Street
Racine, Wisconsin 53403
Attn: Richard R. Kracum

with a copy to:

Kirkland & Ellis
200 East Randolph Drive
Chicago, Illinois 60601
Attention: Karl E. Lutz, Esq. and
Steven V. Napolitano, Esq.

8C. *Assignment.* This Agreement and all of the provisions hereof shall be binding upon and inure to the benefit of the parties hereto and their respective heirs, successors and assigns; *provided* that (i) no such assignment shall relieve the assigning party of its obligations to make any payment pursuant to this Agreement and (ii) no such assignment shall relieve the assigning party of its obligation to indemnify the other party pursuant to Section 7B. The term "assignment" as used herein includes, without limitation, assignments by merger or otherwise by operation of law.

8D. *Severability.* Whenever possible, each provision of this Agreement will be interpreted in such manner as to be effective and valid under applicable law, but if any provision of this Agreement is held to be prohibited by or

invalid under applicable law, such provision will be ineffective only to the extent of such prohibition or invalidity, without invalidating the remainder of such provisions or the remaining provisions of this Agreement.

8E. *Captions.* The captions used in this Agreement are for convenience of reference only and do not constitute a part of this Agreement and will not be deemed to limit, characterize or in any way affect any provision of this Agreement, and all provisions of this Agreement will be enforced and construed as if no caption had been used in this Agreement.

8F. *Complete Agreement.* This Agreement and the agreements and documents referred to herein contain the complete agreement between the parties and supersede any prior understandings, agreements or representations by or between the parties, written or oral, which may have related to the subject matter hereof in any way. Without limiting the foregoing, this Agreement supersedes the Letter Agreement dated October 17, 1989, as amended by the Letter of Amendment dated as of November 1, 1989 and such Letter Agreement, as so amended, shall have no further force and effect.

8G. *Counterparts.* This Agreement may be executed in one or more counterparts all of which taken together will constitute one and the same instrument.

8H. *Governing Law.* The internal law (and not the law of conflicts) of the State of Illinois will govern all questions concerning the construction, validity and interpretation of this Agreement and the performance of the obligations imposed by this Agreement.

8I. *Disclosure Generally.* If and to the extent that any information required to be furnished or disclosed in any Schedule is contained in this Agreement or in any other Schedule attached hereto, such information shall be deemed to be included in each Schedule in which the information is required to be included to the extent the applicability thereof to each such Schedule is clearly apparent.

8J. *No Strict Construction.* The language used in this Agreement will be deemed to be the language chosen by the parties hereto to express their mutual intent and no rule of strict construction will be applied against any Person.

* * *

IN WITNESS WHEREOF, the parties hereto have executed this Agreement as of the date first written above.

ALLOYD HOLDINGS, INC.

By /s/ R R Kracum

Its Chairman

Number of Purchased Shares to be Purchased Hereunder	
83.00	/s/ Arthur L. Gustafson Arthur L. Gustafson
3.929	/s/ Daniel R. McLean Daniel R. McLean
1.964	/s/ Francis I. Butler * Francis I. Butler

Exhibits

Exhibit 1B(a)	Certification of Estimated Adjustment Amount
Exhibit 1B(b).1	Form of Promissory Note
Exhibit 1B(b).2	Escrow Agreement
Exhibit 2A(k)	Non-Compete Agreement
Exhibit 2A(l)	Form of Executive Stock and Employment Agreement
Exhibit 2A(n)	Opinion of Sellers' Counsel
Exhibit 2A(o)	Sellers' Certificate
Exhibit 2A(p)	Form of Subordination Agreement
Exhibit 2B(d)	Opinion of Buyer's Counsel
Exhibit 2B(e)	Buyer's Certificate
Exhibit 4M	Purchase and Sales Order Forms

Schedules

Consideration Schedule
Accounts Receivable
Seller Debt Schedule
Permitted Encroachments Schedules
Transferred Assets Schedule
Subsidiaries Schedule
Seller Encumbrances Schedule
Authorizations Schedule

Financial Statements Schedule
Contracts Schedule
Developments Schedule
Capital Expenditures and Commitments Schedule
Owned Property Schedule
Leased Property Schedule
Encumbrances Schedule
Proprietary Rights Schedule
Litigation Schedule
Seller Brokerage Schedule
Compliance Schedule
Employee Contracts Schedule
Related Party Schedule
Employee Benefit Schedule
Officers and Directors Schedule
Bank Accounts Schedule
Buyer Brokerage Schedule

Financial Statements Schedule (§4D)

ALLOYD CO. INC. AND SUBSIDIARIES

Consolidated Interim Financial Statements

October 31, 1989

(Prepared by management without audit)

Alloyd Co. Inc.

Notes to Interim Financial Statements

October 31, 1989

(1) Inventory.

Inventory amounts shown in the interim financial statements are estimated by management using historical and other material cost information. These estimates are adjusted to actual at the end of the year when the company takes a physical inventory of all materials on hand.

(2) Transaction costs due from shareholders.

Certain costs have been incurred in connection with the anticipated sale of the company. The expenses that are not appropriately deductible by the corporation will be reimbursed by the selling shareholders. Analysis and review of these items will occur upon completion of the sale transaction.

(3) Accrued expenses.

It is the company practice to compute certain accrual amounts for employee benefits and other items during the annual audit process. Interim financial statements reflect estimates of management subject to adjustment at year end.

(4) Non-recurring costs.

Costs incurred during the year while the company has been for sale have been separately stated for purposes of this statement.

(5) Corporation income taxes.

Corporation income taxes have been estimated based on the earnings reflected on this interim statement. Transactions anticipated during the sale of the company and operating results for the remaining two months of the year will have an effect on the tax liability as finally determined at the end of the annual accounting year.

Dtd 12/19/89

Alloyd Co. Inc.
Consolidated Statement of Income and Retained Earnings
for the ten months ended
October 31, 1989

Net Sales	$25,610,915
Cost of Goods Manufactured and Sold	16,845,279
Gross profit	$8,765,636
Administrative, selling and engineering	5,119,239
Income from operations	$3,646,397
Other expense:	
Interest	$492,478
Non-recurring costs (Note 4)	91,195
Total other expense	$583,673

Income before income taxes	$3,062,724
Corporation income taxes (Note 5)	1,300,000
Net income for the period	$1,762,724
Retained earnings, beginning of year	7,452,717
Retained earnings, end of period	$9,215,441
Net income adjusted for certain items:	
Corporate income taxes	$1,300,000
Interest	492,478
Officer's compensation-excess	398,560
Non-recurring costs	91,195
	$2,282,233
Net income after taxes	1,762,724
Net income as adjusted	$4,044,957

168

Dtd 12/19/89

Alloyd Co. Inc.

Interim Balance Sheet

October 31, 1989

ASSETS

Current Assets:	
Cash	$576,998
Accounts receivable, net of customer deposits	3,463,315
Inventory (Note 1)	6,979,277
Prepaid expenses	145,123
Transaction costs, due from shareholders (Note 2)	100,721
Total current assets	$11,265,434
Due from Officer - Shareholder	$44,650
Land, Buildings and Equipment, at cost	$10,927,871
Less - accumulated depreciation	4,555,682
Net land, building and equipment	6,372,189
	$17,682,273

169

LIABILITIES

Current Liabilities:	
Current portion of Notes payable	$2,600,000
Accounts payable	2,230,546
Accrued expenses (Note 3)	672,251
Officer's compensation	180,934
Accrued taxes, other than income	70,697
Corporate income taxes payable	171,280
Total current liabilities	$5,925,708
Long-term notes payable	$2,493,124
Shareholder equity:	
Common stock	$1,000
Paid-in surplus	47,000
Retained earnings (Exhibit 2)	9,215,441
Total shareholder equity	$ 9,263,441
	$17,682,273

(Note: Interim statements are prepared without audit)

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

ALLOYD COMPANY, INC., et al.)
)
Plaintiffs,)
)
vs.) No. 91 C 889
)
ARTHUR L. GUSTAFSON, et al.)
)
Defendants.)

To: The Honorable Ann C. Williams United States District Judge

REPORT AND RECOMMENDATION

Joan H. Lefkow, Executive Magistrate Judge:

• • •

Defendants also point out that the draft section 4D stated that the financial statements "present accurately and completely" the company's financial condition, while the final version says they "present fairly" the company's financial condition.
